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In The Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

CENTRAL TABLET MANUFACTURING CO.,
Petitioner,

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

CIVIL DOCKET
UNITED STATES DISTRICT COURT

CENTRAL TABLET MANUFACTURING CO.
1876 GREENWAY NORTH
COLUMBUS, OHIO
V.
THE UNITED STATES

DOCKET ENTRIES

Date	Proceedings
4-16-69	Complaint filed. Summons, copies complaint MSDO.
5-13-69	Marshal's return filed. Fee $3.00
6-16-69	Answer filed.
11-11-71	Deposition of Larry H. Snyder, filed.
11-30-71	Praecipe for Subpoena filed: James A. Wroe.
12-10-71	Subpoena returned executed 12-6-71, filed. Fee $3.20.

Date	Proceedings
12-10-71	Statement of uncontested facts and of the issues filed.
1-10-72	Brief of Pltf, filed. (to CBR)
1-12-72	Transcript of Proceedings Held 12-21-71 bebefore the Hon. Carl B. Rubin,
1-31-72	Brief for the Defendant, U.S.A. filed.
2-11-72	Reply Brief on Behalf of Plaintiff, Filed.
3- 9-72	Opinion and Order filed: the deficiency assessments entered by the Internal Revenue against the Plaintiff were erroneous as a matter of law and that plaintiff is entitled to refund for its 1963 and 1955 tax years. Judgment is hereby entered in plaintiff's behalf for $81,981.60, less an amount representing the tax difference between ordinary income deduction and the capital expenditure deduction on $8,000.00. This latter figure, and the final judgment award, shall be computed by the defendant, approved by the plaintiff, and forwarded to the Court, within twenty (20) days of receipt of this opinion. (copies to Larry Snyder, and the U.S. Attorney).
3-24-72	Stipulation Re Entry of Judgment, Filed.
3-24-72	Judgment Filed.
5-23-72	Notice of Appeal filed.
6- 7-72	Record certified to the U.S.C.A. 6th

GENERAL DOCKET
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Central Tablet Manufacturing Co.,

Plaintiff-Appellee,

vs.

United States of America,

Defendant-Appellant.

Case No. 72-1582

Date	Filings - Proceedings
6-12-72	Certified record (1 vol. of pleadings, deposition and transcript), filed; and cause docketed
6-14-72	Appearance of counsel for Appellee
6-16-72	Appearance of counsel for Appellant
6-20-72	Appellant's designation of record for appendix
6-20-72	Statement of the issue to be presented by Appellant
6-21-72	Counter-designation of Appellee of record for appendix
7-24-72	Twenty-five copies of Brief for Appellant, with proof of service
7-24-72	Ten copies of Appendix
8-24-72	Twenty-five copies of Brief for Appellee
8-24-72	Proof of service for brief of appellee
9- 7-72	Twenty-five copies of Reply Brief for Appellant, with proof of service
12- 5-72	Cause argued and submitted (Before: McCree, Kent and McAllister, JJ.)
7-12-73	Judgment of the District Court reversed and the case is remanded for further proceedings Z-1.

7-12-73	Opinion by McCree, J.
7-23-73	Appellant's bill of costs with proof of service
8- 7-73	Mandate issued (Costs to be recovered by Appellant—$190.75 for printing)
	Opinion with mandate
10- 3-73	Request for certification and transmission of record to Supreme Court
10- 4-73	Certified record for certiorari mailed to Supreme Court
10- 9-73	Notice of filing for petition for certiorari on 10- 3-73 (Sup. Ct. 73-593)

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

Civil No. 69-116

Central Tablet Manufacturing Co.
1876 Greenway North
Columbus, Ohio 43219

Plaintiff,

vs

The United States

Defendant.

COMPLAINT

1. Plaintiff says that it is an Ohio corporation; that on May 3, 1967, it voluntarily filed a certificate of dissolution in the office of the Secretary of State of Ohio; that under Section 1701.88, Revised Code of Ohio it continues to exist for the purpose of winding up its affairs and has the capacity to bring the within action; and that jurisdiction of this action is conferred upon this Court by Title 28 U. S. C. A., Section 1346 (a).

2. That this action arises under Sections 61 and 451

and Section 337 and Section 1245 of the Internal Revenue Code of 1954, and plaintiff has a just claim against defendant for the sum of $81,981.60, together with interest as provided by law.

3. That plaintiff filed timely reports of its taxable income for the taxable years of plaintiff ending October 31, 1963 and October 31, 1965, and made timely payment of the tax due on the income reported.

4. That on November 22, 1967, plaintiff received a thirty day letter and an examination report and related documents from the District Director of Internal Revenue, Cincinnati, Ohio, copies of which are attached hereto and marked Exhibit A, finding additional tax due for the year ending October 31, 1963, of $11,131.00 and additional tax due for the year ending October 31, 1965 of $62,568.00. [p. 2][5]. That the additional tax found due for the year ending October 31, 1963, in the amount of $11,131.00, together with interest of $799.30, was paid by check dated July 30, 1968, and the additional tax found due for the year ending October 31, 1965, in the amount of $62,568.00, together with interest of $7,483.30, was paid by check dated February 5, 1968.

6. That thereafter on the 18th day of September, 1968, plaintiff filed with the District Director of Internal Revenue, Cincinnati, Ohio in accordance with statute, claims for refund of the additional tax paid for the tax year ending October 31, 1963, together with the interest paid thereon in the total amount of $11,930.30, and for refund of the additional tax paid for the tax year ending October 31, 1965 together with the interest paid thereon in the total amount of $70,051.30, and duly demanded the refund and payment of said amounts with interest as provided by law. Copies of said claims for refund are attached hereto and marked Exhibit B and Exhibit C.

7. That on March 25, 1969, plaintiff filed with the District Director of Internal Revenue, Cincinnati, Ohio, a Waiver of Statutory Notification of Claim Disallowance, copy attached hereto and marked Exhibit D, and Acceptance of Proposed Disallowance of Claim for Refund or Credit, copy attached hereto and marked Exhibit E in connection with the disallowance of its claims for refund aforesaid; that in addition more than six months have passed since the filing of its claims for refund.

8. That on September 10, 1965, a fire occurred at plaintiff's business and manufacturing premises; that on May 14, 1966 the stockholders of plaintiff voted to dissolve the corporation and adopted a complete plan of liquidation of the corporation; that thereafter, and after lengthly negotiations, plaintiff received the sum of $330,509.77 from fire insurance as a result of said fire and received the sum of $67,000.00 from business interruption insurance as a result of the said fire.

9. That the additional tax found due for the taxable year ending October 31, 1965 is based upon the inclusion by the District Director in the taxable year ending October 31, 1965 of the following [p. 3] sums received by plaintiff from fire and business interruption insurance:

a) $223,669.00 (the excess of fire insurance proceeds over net book value) received from fire insurance after the adoption of the complete plan of liquidation on May 14, 1966 and distributed, together with all other assets of plaintiff, within the 12 month period beginning on the date of adoption of the plan of liquidation in accordance with Section 337 of the Internal Revenue Code of 1954 and included by the District Director as long term capital gain in the year ending October 31, 1965.

b) $12,992.00 which represents a pro rata part of the

sum of $67,000.00 received in the year ending October 31, 1967 from business interruption insurance payable as a result of the fire aforesaid.

c) $20,764.00 which represents that part of the total proceeds from fire insurance which is attributable to gain as a result of depreciation under Section 1245 of the Internal Revnue Code of 1954 included as ordinary income on the basis of the contention of the District Director that the proceeds from fire insurance are not excluded from tax under Section 337.

10. That the additional tax found due for the taxable year ending October 31, 1963 results from a decrease in the operating loss carryback to that year on the basis of the following adjustments by the District Director.

a) the inclusion as income for the year ending October 31, 1966 of the sum of $54,000.00 which represents a pro rata part of the proceeds of $67,000.00 received by plaintiff during the taxable year ending October 31, 1967 from business interruption insurance as a result of the fire occurring at plaintiff's premises on September 10, 1965.

b) the disallowance as an expense in the year ending October 31, 1966 of legal fees in the amount of $4,000.00 paid by plaintiff during the year for services rendered in the negotiation and adjustment of the fire insurance losses.

11. That the District Director of Internal Revenue erroneously and illegally determined that Section 337 of the Internal Revenue Code of 1954, is inapplicable to the proceeds from fire insurance received by plaintiff after it had adopted a complete plan of liquidation; and erroneously and illegally determined that the $67,000.00 from business interruption insurance was not taxable in the year ending October 31, 1967, the taxable year in which it was received by taxpayer, but was includable in the income of the two preceding years pro-rated over

the period of business interruption; and erroneously and illegally determined that the sum of $20,764.00 was taxable as ordinary income in the year ending October 31, 1965, under Section 1245 of the Internal Revenue Code of 1954; and erroneously and illegally determined that the sum of $4,000.00 paid for legal services in the year ending October 31, 1966 was not allowable as an ordinary business expense.

12. That no part of the sum of $81,981.60 the total amount of the tax and interest erroneously and illegally collected from plaintiff has been refunded to plaintiff.

WHEREFORE, plaintiff demands judgment against defendant for the sum of $81,981.60, together with interest as provided by law.

/s/ LARRY H. SNYDER
CHAMBLIN, SNYDER AND HENRY
Attorneys for Plaintiff
209 South High Street
Columbus, Ohio 43215

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISION

CIVIL ACTION NO. 69-116

CENTRAL TABLET MANUFACTURING CO.,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

ANSWER

The defendant, the United States of America, by its attorney, Roger J. Makley, Esquire, United States At-

torney for the Southern District of Ohio answers the complaint as follows:

1. Defendant denies present information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 1 of the complaint.

2. Defendant denies the allegations contained in paragraph 2 of the complaint.

3. Defendant admits that plaintiffs tax returns for taxable years ended October 31, 1963, and October 31, 1965, were timely filed but denies present information or knowledge sufficient to form a belief as to the fact of payments with respect thereto.

4. Defendant admits the allegations contained in paragraph 4 of the complaint.

5. Defendant denies present information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 5 of the complaint.

6. Defendant admits that the claim for refund in the amount of $70,051.30 for taxable year ended October 31, 1965, was filed as alleged but denies present information or knowledge sufficient to form a belief as to the filing of a claim for refund for the taxable year ended October 31, 1963.

7. Defendant admits the allegations contained in paragraph 7 of the complaint.

8. Defendant denies present information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 8 of the complaint.

9. Defendant admits the allegations contained in paragraph 9 of the complaint.

10. Defendant admits the allegations contained in paragraph 10 of the complaint, except alleges that the figure in subparagraph (a) included in taxpayer's in-

come for 1966 should read $54,008.00 rather than $54,000.00.

11. Defendant denies the allegations contained in paragraph 11 of the complaint.

12. Defendant denies present information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 12 of the complaint.

WHEREFORE, defendant prays that judgment be entered in its favor dismissing the plaintiff's complaint with prejudice, together with costs and such other and further relief as to the Court seems proper.

/s/

United States Attorney

[CERTIFICATE OF SERVICE OMITTED]

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

Civil No. 69-116

Central Tablet Manufacturing Co.,
Plaintiff,

vs.

United States of America,
Defendant.

DEPOSITION

of LARRY H. SNYDER, a witness called on behalf of Defendant under the applicable Rules of Federal Civil Court Procedure, taken before me, Irmgard E. Modlich, Certified Shorthand Reporter, a Notary Public in and for the State of Ohio, pursuant to agreement, at the offices of Chamblin, Snyder & Henry, 209 South High

Street, Columbus, at 9:30 o'clock a.m., Tuesday, October 19, 1971.

APPEARANCES:

STEPHEN J. CSONTOS,
Attorney at Law,
Tax Division, U. S. Department of Justice,
Washington, D. C. 20530,
On behalf of Defendant.

[2]

Tuesday Morning Session
October 19, 1971

STIPULATION

It is stipulated by and between counsel for respective parties that the deposition of Larry H. Snyder, a witness called on behalf of Defendant, may be taken at this time by the Notary, by agreement of counsel; that said deposition may be reduced to writing in stenotypy by the Notary, whose notes may thereafter be transcribed out of the presence of the witness; that proof of the official character and qualification of the Notary is waived; that the examination, reading and signature of the said Larry H. Snyder to the transcript of his deposition is expressly waived by counsel and the witness, said deposition to have the same force and effect as though signed by the said Larry H. Snyder.

Larry H. Snyder

being first duly sworn, as provided by law, was examined and testified as follows:

Direct Examination

By Mr. Csontos:

Q. State your full name and home address for the

record, please? A. Larry H. Snyder, 324 North Drexel Avenue, Columbus, [3] Ohio.

Q. And your business address? A. 209 South High Street, Columbus, Ohio.

Q. And, Mr. Snyder, you are counsel for the Plaintiff in this action, Central Tablet Manufacturing Company? A. Yes.

Q. And this taxpayer during the years in which it was operating was an accrual basis taxpayer? A. Yes.

Q. Around September 10 of 1965 a fire occurred at the manufacturing plant of this company, didn't it? A. Yes. Manufacturing plant and general offices.

Q. And this resulted in substantial destruction of the properties? A. Yes.

Q. And ultimately as a result of this fire the company went out of business, is that right? A. That's right.

Q. Could you describe for us the types of insurance coverage which the company had in existence as of September 10, 1965? A. Well, they had a building and extended coverage. They had personal property and contents coverage and they had business interruption insurance.

Q. The building coverage, would that have covered[4] equipment or not? A. No, it would not have covered equipment.

Q. Just the physical structure? A. Just the physical structure.

Q. How many policies were there and what were the amounts of those policies? A. There were three policies. The maximum liability on each of the three was $75,000.00, so the total coverage on the surace was $225,000.00.

Q. And the personal property and contents insurance,

what were the limits of those policies? A. $400,000.00, and there was only a single policy as I recall.

Q. And with whom was that policy placed? A. The Home Insurance Company.

Q. And the business interruption insurance, how many policies were there and what were the limits of those policies? A. There were two policies. The specified maximum limit on each was $100,000.00.

Q. Now, those two policies, were they identical except for the insurer? A. Yes.

Q. And with respect to the three building insurance policies, were those policies identical except for the insurers? A. Yes. [5]

Q. Did the company obtain all of these policies from the same insurance agency? A. I believe so. Yes. I am not familiar with the policies. The policies were in existence for some time before I was familiar with them, but I think they did come from the same agency, yes.

Q. Is the agency indicated on these policies? A. Yes. It is the Atkinson-Dauksch and Tallmadge Agencies in Columbus, Ohio.

Q. At what point did you enter the picture with respect to these insurance policies or after the fire? A. Is the after the fire a part of your question?

Q. Yes. What I mean is did you assist in giving notice to the insurance companies? A. Yes.

Q. You did? A. I did.

Q. And was notice promptly given to all of the insurance carriers with respect to the three types of policies? A. It was promptly given although the insurance companies subsequently denied that it was properly given.

Q. Did they deny the sufficiency of your statements?

A. Yes. And the preparation and form in which the proofs of loss were submitted.

Q. And the proofs of loss were submitted when, sir? [6] A. I will have to refer to my files. I don't recall.

Q. All right. According to your files the date on which the notice was given was when, sir? A. October 18, 1965 all the notices to the six involved insurance companies was given.

Q. Now, when did negotiations begin with respect to settlements of any of these three policies or what is the earliest — A. Well, negotiations really didn't start until September of 1965. There was a meeting, as I recall, approximately October 8, 1965 which, again, my recollection is that it was really no more than a preliminary meeting to, really, in some fashion to try and define how we would proceed with negotiations.

Q. And was that with respect to all three types of coverage? A. Well, all three types of coverage of course were involved. The same adjustment firm or adjusting firm represented all of the insurance companies involved in this case.

Q. And who was that, sir? A. The General Adjustment Bureau.

Q. And were you dealing with any one or two particular people there? Were you dealing with several people? A. Principally there were three people that we dealt with. [7]

Q. Who were they? A. Well, one name is Eugene Streng, S-t-r-e-n-g, Wilson Keller was the Secretary, and James Wroe, W-r-o-e, was the third.

Q. Did the representative of the insurance companies ever deny that there was liability under any of these three policies? A. Well, they denied the extent of liability, the exent of coverage, yes.

Q. They said that you were entitled to no recovery under, for example, the business interruption insurance policy? A. No. They never said that. But we did argue with regard to all three types of policies as to the perimeters of the coverage, what was covered, what loss was covered.

Q. All right. So that you didn't have to argue with them about whether or not there was coverage but with respect to how much of the loss was covered. Would that be a correct statement. A. No. Not how much. What loss was — in some instances what loss was covered. I might add, there was some question as to how much of the loss was covered, what the maximum coverage was. But there were also questions as to what was covered by this loss.

Q. Now, what I am trying to drive at, Mr. Snyder, I am sure you are pretty well aware — perhaps I am not phrasing [8] my questions very well — is once negotiations began with The General Adjustment Bureau the parties at least assumed that your client was entitled to some recovery under each of the three different types of policies, isn't that true? A. I think that's fairly stated, yes. But there was a question of what the extent of the coverage was.

Q. And the insurance carriers, did their representatives in these negotiations say that your company isn't entitled to anything whatsoever under the building policy or under the personal property policy or under the business interruption policy? A. No, they didn't say that. But let me explain that they did at one point deny that our proofs of claim were properly presented, and they reserved the right, without saying so obviously, to deny any liability entirely. I will say, in all honesty, I think that was a negotiating position. I don't think seriously

they intended to claim that but nevertheless they took this position officially.

Q. With respect to the business interruption policy, can you tell me when you started discussing hard figures with The General Adjustment Bureau what those figures were in the first instance on your side and their side? A. I can't, without referring to some notes that I made, and I am not sure that they will reveal that exactly but I can look if you want me to. [9]

Q. Fine. A. As near as I can reconstruct from my notes, I believe the question was when did we talk about figures. It had to have been sometime after July of 1966 we talked dollars.

Q. And can you tell from your records, sir, when you first started talking specifically about the business interruption insurance with them? A. The question of business interruption insurance came up really in October of 1965 the first time. The format of that discussion was when the company theoretically, if it were going to go back in business, was required to start rebuilding, what was the length of time that you had to gather your operation together to go forward.

Q. Now, in July of 1966 or after July, in connection with the business interruption insurance, what figures were discussed by you as representative of Plaintiff and by the insurance companies' representatives? A. Well, we started out with the $200,000.00, as I recall, which was the maximum under the policies, under any interpretation of the policies, that could have been recovered. I can't specifically answer your question. The first figure that I recall from reading my notes, and I confess I don't have any independent recollection other than these notes, but the insurer offered $60,000.00 in June of 1967. And I believe at that time we were asking for something over a [10] hundred thousand dollars.

Q. You don't remember whether or not the $60,000.00 was the first figure that was offered by the insurance company? A. No, I don't. I think that it was but I don't recall. I am not positive.

Q. When was it that final agreement was reached with the insurance company concerning the business interruption policy? A. Approximately August 25, 1967.

Q. And was that the final formal agreement when you had an exchange of correspondence? A. No. That was the point at which there was a meeting of the minds. Subsequently the adjusters made up a proof of claim for us and we had the company sign it and it was forwarded. The actual money was received on about September 22, 1967.

Q. Now, in connection with the business interruption insurance would you describe for us the general disputes between your client and the insurance carriers? A. Well, the first area of dispute of course is the one I referred to before. That is, when should rebuilding start if there were going to be rebuilding. Or, put it another way, how much time does an insured have to make plans to rebuild. We were in dispute over that point. And of course this, coming on the front end, would extend the period to be [11] covered by the business interruption.

The second, not necessarily in order of importance at all, but the second area of dispute was whether in projecting the time within which there had to be repair or rebuilding, whether you had to project it on the basis of rebuilding the same kind of building exactly that you had before or whether you could take the time to have architectural services to, well, upgrade technically your building. And we had a dispute about that. Our position was that you didn't have to assume that you had to build an exact replica of the building that was destroyed, that you could under this policy, and it would

extend the time, that you could take the time to request architectural services and that you could actually improve the building that you rebuilt.

A third area of dispute, at the time of the fire the employees or probably ninety percent of the employees of the manufacturing plant, at least of the company, were on strike. A dispute arose as to the projected length of that strike. And this of course was of significance in determining what your net profits would have been had there not been a fire and how long would the strike — obivously then profits were down considerably when there was a strike, and the area of dispute was, well, when would that strike have ended. And we obviously, I guess, took the position, a position that it would have probably ended a lot sooner than at least the [12] adjusters were willing initially to agree that it would have ended.

Then we got in an area of dispute as to whether — let me strike that and say if you are trying to determine under business interruption loss what really the actual loss sustained was, and that's measured by, roughly stated, the net earnings you would have received had you been in business plus any fixed expenses and charges that would have kept going anyway, and we got into an argument there as to whether it was the actual expenses, had to be actual out-of-pocket expenses on the part of the company before they could be reimbursed for them, or whether you ought to project expenses just like you project gross profit, and therefore net profit, on the theory that they were going to get back in business. And we had an argument over that. They took the position that it was only actual out-of-pocket costs that were recoverable. We took the position that this was not true,

that you projected those as you projected your net profits on net earnings.

Well, I would call this minor in the whole picture, but there was some dispute over what expenses were covered, expenses which are incurred to reduce the loss, like supposedly covering machinery that still has some usable value, yet it is out in the open because the roof of the building is gone. And these sort of things. And there was also some dispute [13] as to how we arrived at net earnings. They of course had their accounting firm and we had ours, and they didn't agree specifically on how you arrived at net earnings.

So those were the areas. I would say the first three I mentioned, as I recall it as I thought at the time, were probably the major areas of dispute.

Q. Now, the first two areas that you related were the question of the time for making plans to reconstruct, and the second item you mentioned was whether you had to construct an identical structure or you could modernize or whatever? A. Yes.

Q. Aren't those two really part of the same issue that was raised, how much time do you have at the beginning of the period to begin your plans for reconstruction? A. Well, they are similar. No, they are not the same, I would say. What we were talking about initially, and shortly after our preliminary meeting of October 8, 1965 I received a letter, for instance, from the Adjustment Bureau and I have forgotten from whom from the Bureau. I think it was Wilson Keller, and in effect trying to pin us down as agreeing or having agreed that construction would certainly begin as of this time, that you have had enough time to recover from the shock of the fire loss and it should begin. And we immediately rebutted that letter

by saying that there [14] was no such understanding and that certainly we were not going to be bound by that. But the question of the architect and using architectural services didn't come up until later. It was the same sort of thing, sure, but it was separate from the recovery, so to speak.

Q. Did the parties ever reach agreement on what the recovery period should be? A. No, I don't think we ever did.

Q. How about on the architects, second item that you mentioned? A. We never really reached agreement on that either.

Q. The third item, the strike, did the parties reach agreement on the probable length of the strike? A. No, we didn't reach agreement — I can't say that we did reach agreement on that point either.

Q. The actual loss determination, did you reach any agreement on that? A. We finally settled the claim.

Q. That's the ultimate question, isn't it, with a policy like this, the actual loss? A. I'd say it is the ultimate question, yes.

Q. All these other questions are subsidiary to it and are — A. No. I wouldn't say they are subsidiary to it because if you are talking about actual loss in amount of dollars, [15] of course that's a little different in talking what's covered, what kind of expenses, for instance, are covered. Do you take actual expenses or do you take projected expenses. This goes to the extent of coverage, not just to a dollar amount. The point I am trying to make here, of course, is that we just didn't sit down and figure, well, we come to an agreement what net profit was. There were a lot of elements that could have affected net profit other than the experience of the company in prior years.

Q. All right. Now, the dollar recovery on this thing, Mr. Snyder, did that represent a recovery of actual loss less expenses incurred to reduce the loss? Is that what you were trying to get to? A. We were trying to get to some figure for actual loss, yes.

Q. All right. Is the question of expense incurred to reduce the loss a part of actual loss as you are using that term? A. Well, it is if you can agree on what's included in, properly included in expenses incurred to reduce loss.

Q. The question of how long the strike would continue, that was a question which presumably had to be answered in order to arrive at actual loss, isn't that true? A. Yes.

Q. And the same thing with respect to the time for [16] beginning reconstruction, that entered into the question of what the actual loss sustained by your client was, wouldn't it? A. Yes, it would.

Q. And the same would be true of the question concerning architects, which we discussed earlier, that that entered into the determination of what the actual loss was? A. An actual loss, yes, as dependent on the period of time in those respects, the period of time covered, and of course there was a dispute over the period of time covered.

Q. Did the same individuals from General Adjustment Bureau represent the insurance companies for it? A. Well, my answer to that is yes, although let me say this, that Wilson Keller died I would say probably half way through the negotiations. So that he was in on the earlier negotiations which were largely building, and he wasn't in, of course, on the later negotiation which were partially personal property and business interruption insurance.

Q. And you indicated earlier that Mr. Keller was the top man for the General Adjustment Bureau on this? A. Well, if I did I didn't mean to because I never really knew who was the top man. One would sort of come at you from one direction at one time and another from another. I don't remember whether this was some preconceived plan of operation they had or whether one of them was a little more familiar [17] with the type policy than the other one. I think Mr. Keller was senior chronologically b utI don't know that he was top man for the purposes of this negotiation.

Q. When did negotiation begin on the building insurance? Let me back up. Were there separate negotiations concerning the building policy and the personal property contents policy? A. Well, not entirely, no. They overlapped considerably, as did the business interruption insurance overlap some. We started out, I would say, with the original meeting of hard negotiation. The first matter brought up was the building loss and, as I recall that, that took probably all of that meeting and maybe a couple of others, but down the line we started talking about personal property loss at the same time or at the same meeting that we were talking about building loss.

Q. And when did the negotiations begin concering the building? A. Well, had negotiations began, as I recall, in December of 1965. We had a meeting that 21st or 20th of December in these offices. And that's when my recollection is that my feeling is that hard negotiations began at that point.

Q. And can you tell me what the proposals were on each side at that point in time? A. Well, as I recall, and again we had filed a proof of [18] loss prior to that time claiming the limit, the maximum limit as specified in the policies, of $225,000.00. At this meeting, as I re-

call, General Adjustment — I am not sure that this was an offer — but the figure, as I recall, of $93,000.00 or $97,000.00 came up and they based this, however — immediately we got into the area of whether a reproduction co-insurance clause applied to this insurance, which in substance if it did would have reduced the loss that we could otherwise recover under these policies by some forty-three percent.

Q. Could you explain in some deail what that's about, sir, because I don't really understand it. A. Well, I could do my best to explain it. I am not sure in what detil. But under this reproduction co-insurance clause endorsement, if it was required to insure the building at the reproduction cost of the building less some depreciation. And of course your premiums are paid. The amount of your premiums are contingent upon the value of the building. Our coverage was $225,000.00 total. When we got into some preliminary negotiations some of the cost of reproduction were estimated over $400,000.00. And what the clause, again, if effective, would mean is that your actual loss coverage is reduced by a percentage which is equal to the percentage difference between the amount that you had covered and the actual reproduction cost. [19]

That may not be a good explanation but obviously the purpose of this is to make sure that you don't purposely carry your building, and I suppose it could apply to machinery, too, purposely low and then claim up to the maximum amounts of the policy even though there is not a total loss. And this was our first and probably the biggest problem we had with this building loss.

Q. And your client's position was that this co-insurance clause did not apply, is that right? A. Yes, that was definitely our position.

Q. And what was the basis for that position? A. Well, I'd say initially that it was our position that the accurate interpretation of the clause would make it optional with the insurer as to whether or not that clause was going to apply. How valid that interpretation was, frankly, I don't know.

Secondly, it was our position that the amount of our coverage, the amount of the coverage of the company, was set after discussions with the Atkinson-Dauksch and Tallmadge Agencies, which were also representatives of the insurers, and that the insurers were now estopped to claim that this reproduction co-insurance clause applied to reduce the extent of the liability in this case. So basically those were the positions.

Q. And how was that question ultimately resolved? **[20]** I don't think the question ever was resolved.

Q. How much was the final recovery under that policy? A. The final recovery was $174,595.05.

Q. The $97,000.00 figure proposed by the insurance company in the first instance with respect to the building, was that based upon their concept of this co-insurance clause? A. Well, it was based upon their concept of the co-insurance clause plus the estimate cost of repair of the building, which was estimated by a general contracting firm that they had hired for this purpose. We had an estimate, too. Our estimate was higher than theirs.

Q. Was that a question of repair or replacement at that time? A. Well, that was also a part of the question, whether there was sufficiently left of this building that could be safely and usefully repaired or whether you had to start from scratch. That also entered into the negotiations and the discussions. Again, their contractor was of the opinion that it could be repaired. Ours was of the opinion that while it could be repaired it was far better to replace it because, money-wise, in the long run it would

be saving money to replace it rather than repair it.

Q. Was agreement ever reached on whether the figure should be computed based upon a cost of repair or cost of replacement? [21] A. No. That was never resolved. We finally just agreed upon a figure.

Q. What other disputes were that in connection with the building policy? A. Well, we had a dispute — again, you are trying under the terms of the policy to arrive at the actual cash value, what you are trying to arrive at actually is the cash value of the building. And there was a dispute whether you took the original cost of the building and depreciated over some agreed upon life of the building and arrive at it that way, or whether you took replacement cost, in other words, the cost of replacing it today and depreciated it for an estimated useful life to arrive at your actual loss. They took the position that it was determined by original costs, as I recall, less depreciation, and it was our position that it should be based upon a reproduction cost now less what it would be depreciated over the length of the life of the building.

Q. Was there any dispute as to the depreciation rates? A. Well, yes, there was some dispute as to the rates. As I recall, the total depreciation rate that the insurers or representatives of the insurers first urged upon us was thirty percent. I don't recall how they arrived at that, over what period of time and how it was depreciated, straight line and et cetera, but just on the total we disputed that. [22] We thought that was too high, a thirty percent depreciation.

Q. Was that thirty percent of replacement cost or original cost? A. As I recall, it was thirty percent of original cost.

Q. Was the depreciation question ever resolved? A. No.

Q. Did the parties get any closer on it? A. No. I think

what frequently happened here, it must be obivous to you now, we get into what really were irrevocable positions in theory. And we just have to back off, and ultimately we did agree on a figure without really the determination of how it was arrived at, at least agreed upon determination of how it was arrived at.

Q. According to the draft stipulation, Mr. Snyder, there was an agreement with the insurance company on May 20 of 1966 with respect to the building insurance. Do you have the draft in front of you? A. Yes, I do.

Q. Is that correct, May 20 of 1966? A. Well, I have no independent recollection of it. This draft I prepared back in December of 1969, and from my records and the file here I am quite sure that that's correct. But I would have to go through my files again to say other than it was prepared at that time. I am sure it was correct.

Q. The drafts says the Central Tablet accepted a [23] settlement. Would that have been a written acceptance? A. On the 20th, no, it would not have been. It would have been a meeting of the minds.

Q. And there would not have been a letter to General Adjustment Bureau "We agree to accept such and such"? A. Not on May 20. What would happen, because on May 20 as the result of either a phone call or meeting, and I don't recall which, I would have said to representative from The General Adjustment Bureau, "Well, if you get this amount I think my people will go along with it." And then he would say, "Well, all right, I will check with the insurers. If it is agreeable with them or it looks like they are going to accept it I would prepare proofs of loss and submit them to you and you have your client sign them and submit them to me."

And that would take—well, as the draft indicates that took approximately a month. But this is like any

other negotiation. When we say settlement, the insurers never authorized, at least that was always my understanding, The General Adjustment Bureau to settle the case right on the spot. They always reserved the right to reduce any proof of loss that we submitted as a result of what we considered a meeting of the minds.

Q. Now, six days prior to that, on May 14, 1966, the shareholders of Central Tablet voted to liquidate. Was that [**24**] decision made because a meeting of the minds was imminent with respect to this policy? A. No.

Q. They weren't trying to get the benefits of Section 337 of the Internal Revenue Code with respect to these proceeds? A. Well, let me say this. If we thought that we were going to settle at that time I am sure we would try to get the benefits, but we had no idea that we could have settled this matter at the next meeting if it even was set up at that time. Frankly, that special meeting I am not sure I even attended as a matter of fact, or whether it was a meeting or whether it was by unanimous action of the Board of Directors under the Ohio Revised Code, but it was based upon the fact that it is evident that they are not going to get back in business.

Q. That wasn't evident until that time? A. Well, I don't know whether it was evident exactly or not. Frankly, it was pretty evident to me. I am not sure it was evident to the Board of Directors of Central Manufacturing Company.

Q. With respect to the personal property and content insurance what dispute if any arose concerning it? A. Well, there was a dispute, and one area of the dispute was what machinery and equipment was total loss and what was repairable. That was one area of dispute. There [**25**] was also a dispute over whether some of the loss was incurred because of the fire or whether it was in-

curred by a lack of protection of the machinery after the fire by Central Tablet Manufacturing Company, specifically the roof of the buildings and most of the walls were all gone and some of them where the floor did not fall in and some of the equipment was standing to the elements, the insurance adjusters claimed that the loss was due from rain and failure to adequately protect the machinery. That was an area of dispute.

We also got into the question here, as we did pretty much with the building, and that is whether the machinery is to be valued for the purposes of loss at its original cost less depreciation or whether its reproduction cost less some amount of depreciation. This was all with regard to, as we referred to them, as the fixed assets. We then got into the questions on the purchased goods inventory, which frankly I don't think they are involved here. I don't know whether you want me to go into those or not, and how you determine what your inventory was. And how it should have been reported, whether it was reported properly for the purposes of determining the premium.

Basically those are the three areas of dispute. There was also some question of the cost of repairing those machines which admittedly were repairable, and they had an alleged [**26**] expert, and I had no reason to believe he wasn't, but an expert by the name of MacLean who viewed the property, the equipment and fixed assets at least two times, one of which I was there, and gave his estimate on some of the larger machinery that could be repaired, what it would cost. We also had a person whom we considered to be an expert to look at this and he gave his estimate. Those estimates varied considerably, I would say.

Q. Now, this morning you made available to me sev-

eral files pertaining to the insurance negotiations. Are these all of the files that you have concerning it, sir? A. Concerning what?

Q. The insurance negotiations. A. Those are all of the files that I have, yes. I have in my possession two of my case files. I don't think that there is anything in there that isn't of a legal, argumentative nature, but I wouldn't swear that there isn't a paper in there that might properly be in there. Basically those are the files which relate to negotiations plus this file that I have before me now and have been referring to and which you also were furnished.

Q. Mr. Snyder, I am pretty well finished with the questions on these insurance negotiations and I would like to discuss with you on the record to find out exactly where we are in disagreement on the issues. Now, this may be getting [**27**] a little out of line for a deposition and if you object to it we can cut it off. A. Let me hear your questions first. If I object to them —

Q. We are in agreement with respect to the dollar amount of capital gains on which your client would be taxable if Section 337 of the Internal Revenue Code does not apply. A. Would you read that question back?

(The question was read.)

A. Well, yes, I do object to answering these questions on the record, this question. If the others are similar I object to those. I am perfectly willing to sit down with you and discuss what we are in agreement on and what we aren't, but if the purposes of making it on the record are to get admissions obviously I will reflect on the pleadings and everything else before I make any such admissions.

Q. All right. In connection with the business interruption insurance negotiations, was it your client's posi-

tion that the business interruption period should be computed through May 31, of 1966? A. Basically our position was that it should cover so many months. I don't know what the date was and I am not really that —yes. As I said, and you have handed to me a letter of June 28, 1967, and a letter to General Adjustment Bureau in which I said, "As we stated to you at our meeting [28] on June 21, 1967 and previous meetings we feel strongly that an estimated period of business interruption in this case cannot be reasonably less than thirty-seven and a half weeks or from the time of loss to May 31, 1966."

MR. CSONTOS: No further questions.

Do you want to sign this deposition or do you waive signature?

THE WITNESS: I waive signature.

(Thereupon, at 10:40 o'clock a.m., Tuesday, October 19, 1971, the deposition was concluded.)

CERTIFICATE

[29]

STATE OF OHIO)
COUNTY OF FRANKLIN) SS:
)

I, Irmgard E. Modlich, CSR, a Notary Public duly commissioned and qualified in and for the State of Ohio, do hereby certify that there came before me on the 19th day of October 1971 at 9:30 o'clock a.m., at 209 South High Street, Columbus, Ohio, the following named person, to-wit, Larry H. Snyder, who was by me duly sworn to testify to the truth and nothing but the truth of his knowledge touching and concerning the matters in controversy in this cause; that he was there-

upon carefully examined upon his oath and his examination reduced to writing by me; that the deposition is a true record of the testimony given by the witness.

I further certify that I am neither attorney or counsel for, nor related to or employed by, any of the parties to the action in which this deposition is taken, and further, that I am not a relative or employee of any attorney or counsel employed by the parties hereto or financially interested in the action.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this 27th day of October, 1971.

IRMGARD E. MODLICH, *CSR, Notary Public in and for the State of Ohio.*

My commission expires
September 29, 1973

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION
CIVIL ACTION NO. 69-116

CENTRAL TABLET MANUFACTURING CO.,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

STATEMENT OF UNCONTESTED FACTS AND OF THE ISSUES

Come now the plaintiff and the defendant by their respective attorneys pursuant to the Court's order and submit the following statement of uncontested facts and of the issues, subject to their right, if a trial is held, to introduce further evidence not inconsistent with these facts and to their rights to object to the relevancy or materiality of any facts herein:

A. Statement of Uncontested Facts

1. Central Tablet Manufacturing Company, (hereinafter referred to as "Central Tablet"), for many years prior to May 14, 1966, was an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items at Columbus, Ohio.

2. On August 13, 1965, a majority of the production and maintenance employees of Central Tablet went on strike over failure to reach a collective bargaining agreement with Central Tablet and production was reduced to approximately 5% of normal volume.

3. On September 10, 1965, and during the course of the strike, an accidental fire largely destroyed Central Tablet's manufactory and manufacturing equipment and machinery and its business offices.

[p. 2] 4. The buildings of Central Tablet were never rebuilt or repaired and the manufacturing equipment was never replaced or repaired following the fire, and the strike of production and maintenance employees was never settled and Central Tablet never again engaged in manufacturing.

5. As of September 10, 1965, plaintiff carried fire and extended coverage insurance on its building, and on its machinery and inventory. It also carried business interruption insurance. The stated dollar limit of liability on the building was $225,000 under three separate policies of $75,000, which were identical, except for the insurer. A copy of one of these policies is attached hereto as Exhibit 1. The stated dollar limit of liability on the machinery and inventory was $450,000 under one policy. A copy of that policy is attached hereto as Exhibit 2. The stated dollar limit of liability for business interruption was $100,000 under two policies which

were identical except for the insurer. A copy of one of these policies is attached hereto as Exhibit 3.

6. Negotiations of Central Tablet's claim for business interruption loss began on approximately October 8, 1965. Negotiation of the business interruption loss claim of Central Tablet produced a dispute between Central Tablet and its insurers as to the estimated period of loss to be covered by business interruption insurance and a dispute over the probable duration of the strike of the production and maintenance employees of Central Tablet, had there not been a fire, for the purpose of determining the "actual loss sustained" by Central Tablet during the period of loss covered under the insurance policies.

7. Negotiations of Central Tablet's insurance claims for building and machinery and personal property losses began on approximately November 1, 1965. Dispute arose as to the applicability of a co-insurance clause in the building insurance policy and as to the extent of the building loss and the value of the building at the time of loss and as to the value of machinery and equipment that was destroyed or damaged and as to the extent of damage to machinery and equipment and the cost of repair of repairable machinery and equipment.

8. On May 14, 1966, at a special meeting held pursuant to notice, the shareholders elected to dissolve Central Tablet and adopted a plan of dissolution and [p. 3] complete liquidation. A copy of the minutes of that meeting is attached hereto as Exhibit 4.

9. Prior to this time (May 14, 1966), neither the Board of Directors nor the shareholders of Central Tablet had adopted a formal plan of liquidation of the Company.

10. On approximately May 20, 1966, Central Tablet accepted a settlement of its building insurance claim

and on or about June 15, 1966, reecived $174,595.05 in payment of its building loss.

11. A certified copy of the Resolution of Stockholders and Plan of Dissolution, together with Treasury Department Form 966, was filed with the District Director of Internal Revenue, Cincinnati, Ohio on May 25, 1966.

12. On approximately August 25, 1966, Central Tablet accepted a settlement of its personal property insurance claim and on or about November 17, 1966, received $104,609.27 in payment of its personal property loss.

13. On May 3, 1967, all remaining assets after liquidating distributions to shareholders were conveyed to The Ohio National Bank of Columbus, Ohio, in trust for shareholders pending the complete winding-up of the affairs of Central Tablet, including the payment of taxes and the collection of its insurance claims and all other claims and choses in action. A copy of the appointment of the trustee is attached hereto as Exhibit 5.

14. On May 3, 1967, Central Tablet filed a Certificate of Dissolution with the Secretary of State of Ohio pursuant to Section 1701.86, Revised Code of Ohio.

15. On August 25, 1967, the directors negotiated a settlement of the insurance claim for business interruption loss and on or about September 22, 1967, received $67,000 in payment of the loss.

16. At all times relevant to the issues in this action, taxpayer reported its income for Federal income tax purposes on an accrual basis.

17. On approximately January 26, 1968, a fiduciary assessment was made against Central Tablet for the tax year ending October 31, 1965, in the amount of $70,051.30. This assessment was based upon the inclusion by the District Director of the following sums plaintiff received from fire and business interruption insurance:

[p. 4] (a) $223,669.00 (the excess of fire insurance proceeds over net book value and $4,000.00 legal fee assigned as a cost of sale) received from fire insurance after the adoption of the complete plan of liquidation on May 14, 1966, and distributed, together with all other assets of plaintiff, within the 12-month period beginning on the date of adoption of the plan of liquidation in accordance with Section 337 of the Internal Revenue Code of 1954 and included by the District Director as long-term capital gain in the year ending October 31, 1965.

(b) $12,992.00 which represents a pro-rata part of the sum of $67,000.00 received in the year ending October 31, 1967, from business interruption insurance payable as a result of the fire aforesaid.

(c) $20,764.00 which represents that part of the total proceeds from fire insurance which is attributable to gain as a result of depreciation under Section 1245 of the Internal Revenue Code of 1954, included as ordinary income by the District Director.

18. On February 8, 1968, Central Tablet paid the above deficiency assessment of $70,051.30 in full.

19. On approximately July 19, 1968, a deficiency assessment was made against Central Tablet for the tax year ending October 31, 1963, in the amount of $11,930.30. This assessment resulted from a decrease in the operating loss carryback to 1963 on the basis of the following adjustments by the District Director:

(a) The inclusion as income for the year ending October 31, 1966, of the sum of $54,008.00, which represents a pro-rata part of the proceeds of $67,000.00 received by plaintiff during the taxable year ending October 31, 1967, from business interruption insurance as a result of the fire occurring at plaintiff's premises on September 10, 1965.

(b) the disallowance as an expense in the year ending October 31, 1966, of legal fees in the amount of $4,000.00 [p. 5] paid by plaintiff during the year for services rendered in the negotiation and adjustment of the fire insurance losses.

20. On July 31, 1968, Central Tablet paid the above deficiency assessment of $11,930.30 in full.

21. On September 18, 1968, claims for refund of the deficiency assessments made against Central Tablet for the tax year ending October 31, 1963, and the tax year ending October 31, 1965, were filed with the District Director of Internal Revenue, Cincinnati, Ohio.

22. On approximately March 25, 1969, a Waiver of Statutory Notification of Claim Disallowance and Acceptance of Proposed Disallowance of Claim for Refund or Credit, was filed with the District Director of Internal Revenue, Cincinnati, Ohio.

23. More than six months having elapsed since the filing of its claim for refund, Central Tablet's initiation of the instant proceeding on April 16, 1969, is timely, and all other jurisdictional prerequisites have been satisfied.

24. Although plaintiff does not agree in any way or part with the legality or validity of the District Director's legal conclusions or of the deficiency assessments, based upon such conclusions, which are the subject of this action, it does agree to the arithmetical breakdowns by the District Director, which are shown in paragraphs 17 and 19 above.

B. **Defendant's Statement of the Issues**

1. Whether the $223,669 of gain attributable to the fire insurance proceeds with respect to the building, the machinery and the inventory is exempt from taxation by reason of Section 337 of the Code.

2. If plaintiff is taxable on the gain attributable to the

fire insurance proceeds, whether since plaintiff is on the accrual basis of accounting the income is taxable in plaintiff's tax year ending October 31, 1965, or 1966.

3. Whether plaintiff is taxable on $12,992 and $54,008 for its tax years ending October 30, 1965, and 1966, respectively, which represents the pro-rata portions of the $67,000 of business interruption insurance proceeds received by plaintiff during its October 31, 1967, tax year.

[p. 6] 4. Whether $20,764 of fire insurance proceeds which represents income from the recapture of depreciation is taxable to plaintiff during its tax year ending October 31, 1965, as defendant contends, or during its tax year ending October 31, 1966, as plaintiff contends.

5. Whether plaintiff is entitled to a deduction of $4,000 for its tax year ending October 31, 1966, for legal fees attributable to negotiations and settlement of the insurance losses.

C. **Plaintiff's Statement of the Issues**

1. Are the nonrecognition of gain provisions of Section 337 of the Internal Revenue Code applicable to the fire insurance proceeds received as a result of the fire losses to the building, machinery and inventory.

2. If Section 337 of the Code is inapplicable to the insurance proceeds from the fire losses to the building and machinery and inventory, are these proceeds taxable in plaintiff's tax year ending October 31, 1965, the year in which the fire occurred, or in the tax year the proceeds were received.

3. Are the proceeds from business interruption insurance taxable, proratably, in plaintiff's tax years ending October 31, 1965 and October 31, 1966, the years of the loss period, or in plaintiff's tax year ending October 31, 1967, the year in which the proceeds were received by plaintiff.

4. Is $20,764 of fire insurance proceeds, representing income from the recapture of depreciation under Section 1245, taxable in plaintiff's tax year ending October 31, 1965, the year in which the fire occurred, or in plaintiff's tax year ending October 31, 1966, the year in which the proceeds were received.

5. Whether plaintiff is entitled to a deduction of $4,000 for its tax year ending October 31, 1966, for legal fees attributable to negotiations and settlement of the insurance losses.

Respectfully submitted,

LARRY H. SNYDER,
209 South High Street,
Columbus, Ohio 43215
WILLIAM W. MILLIGAN
United States Attorney
By: /s/Stephen J. Csontos
STEPHEN J. CSONTOS
Trial Attorney-Tax Division
Department of Justice
Washington, D.C. 20530
202-739-3659

[Exhibits 1 through 3 omitted]

EXHIBIT 4

CENTRAL TABLET MANUFACTURING COMPANY SHAREHOLDER RESOLUTION AND PLAN OF DISSOLUTION

May 14, 1966

The shareholders of Central Tablet Manufacturing Company, at a meeting held for the purpose of voting upon the voluntary dissolution of the Corporation, by the affirmative vote of the holders of shares entitling

them to exercise two-thirds of the voting power of the Corporation on such proposal, take the following action:

RESOLVED THAT, Central Tablet Manufacturing Company be dissolved and that the dissolution of the Corporation, the winding up of all of its affairs and the distribution of its property shall be in accordance with the following plan of liquidation:

1. The Board of Directors and/or the authorized officers of the Corporation are authorized to proceed with negotiations for the sale and to sell the assets of the Corporation and to adjust and settle any and all insurance claims of the Corporation on such terms and for such amounts as is determined to be in the best interests of the Corporation, and to take legal action or other appropriate action in the event that insurance claims cannot otherwise be adjusted or settled, and to take any other actions necessary or appropriate to liquidate the assets of the Corporation and to wind up its affairs, including the payment of all debts, fees, taxes and expenses and other charges of the Corporation to the date of dissolution and all charges and expenses payable in connection with the dissolution and winding up of the affairs of the Corporation.

2. In accordance with the terms of the Class A Preferred Stock of the Corporation, holders thereof shall be entitled to be paid the par value of their shares plus all accrued and unpaid dividends at the cumulative rate of 3% per annum out of the assets and funds of the Corporation before any distribution is made to Common Stockholders; thereafter, all of the assets and funds of the Corporation shall be distributed to Common Stockholders proportionately with the number of shares owned by each.

3. The dissolution shall be completed within one

year from date hereof and the President of the Corporation is authorized and directed to file Form 966 with the District Director of Internal Revenue.

4. The President and Secretary of the Corporation shall file a Certificate of Dissolution with the Secretary of State of Ohio and take all other necessary steps required by Section 1701.86, Revised Code of Ohio, for the voluntary dissolution of the Corporation.

5. The Board of Directors and/or the authorized officers of the Corporation shall take immediate steps to terminate all business activities of the Corporation and proceed with the necessary steps to wind up its business affairs and to consummate the dissolution.

* * * * *

[Signatures omitted]

I hereby certify that the foregoing is a true and correct copy of the Resolution of Shareholders of Central Tablet Manufacturing Company and Plan of Dissolution adopted at a special meeting of shareholders held at Columbus, Franklin County, Ohio on May 14, 1966.

/s/ Raymond E. Kessler
RAYMOND E. KESSLER, Secretary
Central Tablet Manufacturing Company

Dated this 19 day of May, 1966

TRANSCRIPT OF PROCEEDINGS
HELD DECEMBER 21, 1971

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISION

CIVIL ACTION NO. 69-116

CENTRAL TABLET MANUFACTURING COMPANY,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

[Tr. 3]

JAMES WROE

Called as a witness on behalf of the Defendant, being first duly sworn, testified as follows:

DIRECT EXAMINATION

by Mr. Csontos:

Q. Would you state your full name and home address for the record, please? A. James Albert Wroe, 2154 Tremont Road, Columbus.

Q. And what is your present occupation? A. Insurance adjustor.

* * * * *

Q. All right. So, you were employed by the General Adjustment Bureau from about 1958 through 1967? A. Correct.

Q. And what period of time was here in Columbus with the General Adjustment Bureau? A. I was in Columbus two different times. I was here in 1949 through 1951, and then I returned in 1960 until my termination in 1967.

Q. Now, could you describe for the Court the function

of the General Adjustment Bureau? A. We function solely upon assignments from insurance companies to investigate all types of insurance claims for them, reporting solely to them and, of course, negotiating adjustments pursuant to those insurance contracts.

Q. Now, when a case is assigned to you or was assigned to you at the General Adjustment Bureau by an insurance company, what would normally be done at first in connection with this particular claim? A. With the particular claim at hand?

Q. Yes, sir. A. Well, of course it is identical to most of them we receive normally as assignments to the company's agent. That is the local insurance agent, or we did that. We received the assignment from them, and we confirmed that the coverage is current and proceed to the risk; that is, the property, and in this case as it was fire, we established that there was a fire and subsequently or ultimately as to what the extent of damage is.

Q. As an adjustor with the General Adjustment Bureau, did you make decisions concerning whether or not there was coverage or liability under a particular policy? A. Yes, I think we determined coverage and liability.

Q. And at what point in time would that be with relation to the time when the assignment was made to the General Adjustment Bureau? A. Well, in the instant case, what we are talking ab:out when we are speaking of fires, it was obvious that there was a fire. It was in progress when I was first on the scene. Now, liability is is not a factor there. I mean, the contract provides the coverage for fire, and what remains then, is to establish the extent of damage.

* * * * *

Q. All right. Now, if there had been a question in your mind as an adjuster with respect to these matters,

would the matter have been discussed with the representatives of Central Tablet Manufacturing Company? A. The question of the policy being voided?

Q. Yes, sir. A. Yes, certainly it would have been discussed with representatives of Central Tablet.

Q. Now, if a question such as that arises, does the General Adjustment Bureau have final authority to make the determination on that? A. No, I don't think they would have any authority. We are only agents as adjustors for the companies, and we only report to them our findings. All the decisions as far as the policies' interpretation would have to be done by the companies.

* * * * *

[Tr. 8]

* * * * *

Q. There were negotiations concerning the amount of liability of the insurance companies under these various policies, weren't there, sir? A. Amount of loss, is that what you mean by liability?

Q. Yes, sir. A. Yes, sir.

* * * * *

CROSS-EXAMINATION

by Mr. Snyder:

Q. Mr. Wroe, as I understand it from your testimony, General Adjustment Bureau was the negotiator for all of the insurance claims that were presented by Central Tablet Manufacturing Company. A. That's right.

Q. Now, that included business interruption insurance, building insurance, and personal property insurance did it not? A. That's correct.

Q. You participated in some degree in all of the negotiations, did you not? A. In some degree, yes.

Q. And in the process of negotiating these claims, the claims were considered simultaneously, were they not?

What I am getting at is one wasn't necessarily gotten out of the way before another was discussed, was it? A. I think during the progress of the adjustment process, we did many times discuss various phases of all three sections, but of course, obviously they were resolved at different times. They weren't all resolved at one time.

Q. Do you recall the approximate period of time of the negotiations with Central Tablet Manufacturing Company?

MR. CSONTOS: Your Honor, we stipulated as to when the fire occurred, as to when the supplement was arrived at, and when the amounts were received, and I don't know that this witness has independent recollection after that time of this nature.

THE COURT: I am going to permit him to answer, Mr. Csontos. I am not sure where it is leading.

MR. SNYDER: I am just trying to get a little background for the next question, Your Honor.

THE WITNESS: As I recollect, the fire occurred September 10, 1965.

Q. (By Mr. Snyder) That's my recollection too. A. And we, of course, commenced work on it at that time, and I actually do not know when any of them were settled. I am sure that one of them was settled the following year, during '66. I am not exactly sure that I was even here when the other two phases were concluded.

Q. Let me ask you this question, Mr. Wroe: Isn't it true that there were a number of meetings between you and other representatives of General Adjustment Bureau and representatives of Central Tablet Manufacturing Company over a considerable period of time to attempt to settle these claims? A. That's correct.

Q. Now, referring specifically, Mr. Wroe, to the bus-

iness interruption insurance, isn't it true that the policy purported to cover the actual loss sustained during the period of the business interruption as measured by gross earnings less cost and expenses that were not incurred?

MR. CSONTOS: Your Honor, the policy is in evidence. It speaks for itself. It is in evidence. He is asking him what the terms of the policy were.

THE COURT: Now, Mr. Snyder, you may speak.

MR. SNYDER: Yes, Your Honor. Let me say this: I don't think there is any secret here. The question is whether the liability was — this is one of the large questions in this whole case, whether the liability was fixed in certain. I am attempting to show, frankly, through this witness that at least the extent of the liability was not fixed in certain during the time that the district director purported it to be. I am attempting, frankly, to establish through this witness, that there were a number of factors involved here upon which the General Adjustment Bureau and Central Tablet Manufacturing Company did not agree. The only way I can get to that is to ask a specific question of this nature. **[12]**

THE COURT: I am going to overrule the objection. You may proceed.

Q. (By Mr. Snyder) Mr. Wroe, isn't it a fact that in determining the business interruption loss that gross earnings are a factor to be considered? A. In this policy, yes.

Q. In this policy, that's what I am talking about. A. There are different methods to write business interruption. This was a gross earnings form.

Q. And isn't it also a fact that the length of time required to get back into business is a factor to be considered? A. The policies of this nature state with due diligence and dispatch.

Q. Now, in determining the period of due diligence and dispatch necessary to get back into business, isn't it true that under this particular policy, a reasonable time under the interpretation of this policy was allowed for planning and adjustments before the actual time of construction or repair or whatever it is commences? A. Well, in all policies, there is a reasonable time from the date of the fire that is necessary, and it would vary, of course, from one instance to another.

Q. Now, do you recall whether the insurers and the insured in this particular case agreed on what a reasonable [13] time would be for the planning and adjustment before the time would starting running for the construction and repair? A. I don't personally remember whether it was agreed or disagreed. I am sure it was a matter of negotiation because this was a case where it never was rebuilt.

Q. So, we had to project everything; is that not correct? A. That's correct.

Q. Were the insurers and the insured in this case ever agreed upon what a total reasonable time of suspension would be? A. I personally don't think I was in on that final part. Obviously, it was agreed or there wouldn't have been a payment.

Q. Well, not necessarily, Mr. Wroe. Let me ask you this: Do you recall that at the time of the Central Tablet fire on September 10 of 1965 that the production and maintenance employees were out on strike? A. Yes, they were.

Q. Do you recall that at that time production was practically at a standstill? A. That's correct.

Q. Now, with production at a standstill, this would affect gross earnings, would it not? A. Certainly. [14]

Q. Now, wasn't there an issue and wasn't there a dis-

pute in this case as to the projected length of time of that strike? A. Yes.

Q. And didn't the insurers and the insured disagree as to the probable duration of that strike, the projected duration of that strike? A. I am sure that couldn't have been more than conjecture. It had to be negotiated.

THE COURT: Mr. Snyder, do let the witness finish his answer.

MR. SNYDER: I am sorry.

THE COURT: Would you finish your answer.

THE WITNESS: I say that, yes, they were on strike and the period that the strike would have continued is a matter of conjecture. It is bound to have been negotiated or a disputed item. From my knowledge, there have been no definite arrangements or time established by the union negotiators and the owners as to when they are going to go back to work, so it is a matter of conjecture.

Q. But you will agree that this item, this element becomes a factor in determining the amount of loss, will you not? A. Yes, sir.

Q. And you are also agreeing, or do you recall that [15] that element, the length of time, was in dispute? A. Yes, sir.

Q. Was there ever a specific agreement reached, to your knowledge, about what the duration of the strike probably would have been had the company gone back in business? A. I don't recall. I don't think that could have been done. It went on for over a year's time, and I don't think I was even involved in the final disposition of that.

Q. Well, isn't it a fact, Mr. Wroe, that no specific conclusion was reached, but the final settlement was merely a compromise in the positions taken by both sides of this? A. I think that's a fair statement.

Q. Mr. Wroe, you also participated in part, at least,

in the building loss negotiations, did you not? A. Yes, sir.

Q. Do you recall that on approximately November 5, 1965, Central Tablet or representatives, agents of Central Tablet submitted what was labeled a proof of building loss? A. My review of the file since that time supposedly establishes that, yes.

Q. I don't mean to cut you off.

THE COURT: Do finish your answer, Mr. Wroe.

THE WITNESS: I don't specifically remember this, no. [16]

Q. (By Mr. Snyder) You don't specifically remember? A. No.

Q. Do you specifically remember that the General Adjustment Bureau acting as representatives or agents of the insurers of the building instructed you to write the Central Tablet saying that those proofs of losses were rejected as such? A. That's right. I do remember that.

Q. I believe you testified on direct examination that under these policies it was incumbent upon the insured to file a proof of loss within 60 days; is that correct? A. I think I said the contract provides any insured to file a proof of loss within 60 days.

Q. What happens if it not filed within 60 days? A. The insurance companies interpret their own contracts. The contract provides for this. If they do not file it within 60 days, we so inform the insurance companies, and then we abide by their rulings on this whether or not we continue our participation in the adjustment process or so advise the insured that the insurance companies have chosen not to provide coverage.

Q. I see. Would your answer be the same in the event that a proof of claim is rejected for not being properly filed? A. State that again. I don't understand. [17]

Q. Well, let me put it this way: What is the effect of

an insurance company informing the insured that they have not properly filed a proof of claim? A. In this case, we were instructed to reject the proof of loss as not having satisfied the contractual conditions.

Q. This building loss policy, and I am not too familiar with the terms, so bear with me, carried what is called as a replacement cost endorsement co-insurance clause; is that not correct? A. My memory is that it did.

Q. What generally is the purpose and effect of this sort of a clause? A. First of all, the replacement cost endorsement is either sold by the agents or bought by the insured for the purpose of having put back new materials where the previous ones had certain age or physical deterioration on them. The co-insurance clause is an application where the insurance company requires that the insured carry coverage up to a sufficient limit or up to a sufficient amount so that they will get adequate premiums to justify affording this replacement cost coverage.

Q. What happens if in a particular case the coverage isn't high enough to get the premiums that the insurer thinks they should have received? [18] A. The adjustors have nothing to do with premiums.

Q. Well, what happens if the insurers take the position that the co-insurance clause is effective in a case like this? A. The co-insurance clause contains its own wordage as to the effect of it, and it is written between 80 and 90 percent. I mean, if it is 80 or 90 percent, it is shown and the premiums are chosen from that. If you choose to maintain limits up to that amount, then your coverage is based on a formula as to the amount that you are deficient; that is, the amount carried over the amount required times the loss.

Q. Your coverage, in effect, is reduced, then; is that not correct? A. Yes.

Q. In fact, Mr. Wroe, didn't a dispute arise in this case as to the aplicability of a co-insurance clause in that policy? A. I really don't think I can answer that. We had numerous discussions and co-insurance is also an application in that type of coverage and also a part of a replacement cost coverage. It is also required that you collect replacement cost provided that the actual replacement be accomplished on the same premises. So, I really don't know how deeply we got involved in the co-insurance clause [**19**] application.

MR. CSONTOS: If it please the Court, if it will save time, the Government has stipulated to the fact that the dispute arose concerning the co-insurance clause. It is in the stipulation.

THE COURT: All right.

MR. CSONTOS: As is much of this other testimony.

THE COURT: Mr. Snyder, did you plan to question further on that issue?

MR. SNYDER: No. I think I have exhausted it, Your Honor. He has answered that he has no recollection, as I understood him, and it is a matter of stipulation. Let me say this: I don't know that I am limited in the extent to which I can cross-examine this witness on what we are here for.

THE COURT: Mr. Snyder, I ame not seeking to limit you, but if something has been stipulated to, it really dosen't serve much purpose to interrogate him on that subject.

MR. SNYDER: No, sir, but let me by way of explanation say this: The only thing I was trying to bring out by this witness was if this co-insurance clause endorsement were in effect, it would have reduced the policy coverage by some 43 percent. So, this is what I am trying to say.

THE COURT: Do recall, Mr. Snyder, this is to the [20] Court. I do understand the option of co-insurance clauses.

Q. (By Mr. Snyder) Mr. Wroe, let me ask again referring you to the proofs of claim that were filed by the insured in this case, isn't it a fact that under all policies, the proofs of loss were rejected by the insurers, both as to business interruption insurance, real property, and personal property? A. As best I can remember, they probably all were rejected.

Q. Isn't it a fact, Mr. Wroe, that in considering the building loss, there was also a difference of opinion or disagreement over whether or not depreciation should be taken into account in determining the loss to the building? A. I don't think I can specifically answer that because if we are talking about a replacement cost endorsment, we are talking about replacement cost coverages and depreciation is not involved in it from the outset. So, I don't know.

Q. All right. Do you recall that the insurers or your company, I don't know which, retained a building contractor to examine the building and to give an opinion to you as to whether or not the building was repairable or had to be reconstructed? A. That's correct, we did employ a contractor.

Q. Isn't it true that the insured also retained a [21] contractor for the purpose of giving that contractor's opinion as to whether or not the building was repairable? A. I am sure that is correct.

Q. Do you recall that there was a difference in the opinions given? A. Yes, sir.

Q. They did not agree; is that correct? A. I am sure they did not agree.

MR. SNYDER: Let me try and telescope this a little, Your Honor.

Q. (By Mr. Snyder) You also participated to some degree in the negotiations of the personal property loss, did you not? A. Yes, sir.

Q. And I believe this was a single policy coverage, was it not?

MR. CSONTOS: That has been stipulated, Your Honor.

MR. SNYDER: I am trying to give the witness some lead in the questions. I know it has been stipulated.

Q. (By Mr. Snyder) Mr. Wroe, isn't it a fact that the insured and the insurers disagreed as to machinery that was repairable? What I mean by that is: Isn't it true that the insurers took the position that some machinery was repairable and that insured took the position that it was not repairable? **[22]** A. The same pieces of machinery?

Q. Yes. A. That is correct.

Q. Do you recall incidents like that? A. Yes.

Q. Do you also recall that in specific instances there was disagreement over the cost of repairing machines or equipment that was agreed to be repairable? A. I am sure that there was disagreement on that.

Q. Isn't it a fact that there was a disagreement or a difference of opinion over whether the loss coverage under the personal property loss was replacement cost less depreciation as contrasted with the net book value of machinery? A. As I remember, the difference in the manufacturers' output policy was whether it was a market value or a manufacturer's cost. I mean, replacement cost is not involved in this.

Q. In your opinion, it is not involved? A. That's my opinion.

Q. But you do recall there was a difference of opinion in how we arrived at the loss?

THE COURT: I think he testified to that, Mr. Snyder.

As I understand it, Mr. Wroe, there are two areas. There was a difference of opinion as to wether a specific piece of machinery was repairable and there was a [23] difference of opinion as to the cost of repairing machinery that was repairable.

THE WITNESS: The differences were based upon opinions of two different repair sources and, yes, sir, there was a difference in both cases, both as to whether a machine was repairable, and if a machine was repairable, what amount of money it would take to repair it, yes.

THE COURT: That was what I understood him to testify to.

Opinion And Order Of District Court May Be Found Beginning At Page 11 Of The Petition For A Writ Of Certiorari

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISON

Civil Action No. 69-116

CENTRAL TABLET MANUFACTURING COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT

Filed March 24, 1972

This action came before the Court for trial and the issues having been duly heard and the Court having rendered its verdict,

IT IS ORDERED AND ADJUDGED,
that the plaintiff, Central Tablet Manufacturing Company, recover $11,930.30 pertaining to its October 31, 1963 tax year and $69,862.09 pertaining to its October 31, 1966 tax year, plus interest provided by law, and its costs of action.

Dated this 24th day of March, 1972.

CARL B. RUBIN
United States District Judge

APPROVED AS TO FORM:

LARRY H. SNYDER, Esquire
Attorney for plaintiff

STEPHEN J. CSONTOS
Attorney for defendant

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISION

Civil Action No. 69-116

CENTRAL TABLET MANUFACTURING COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

NOTICE OF APPEAL

Notice is hereby given that defendant, United States of America, hereby appeals to the United States Court of Appeals for the Sixth Circuit from the judgment entered in this action on March 24, 1972.

WILLIAM W. MILLIGAN
United States Attorney
By /s/ W. ROBINSON WATTERS
Assistant United States Attorney

Opinion Of The Court Of Appeals May Be Found Beginning At Page 22 Of The Petition For A Writ Of Certiorari

Judgment Of The Court Of Appeals May Be Found At Page 31 Of The Petition For A Writ Of Certiorari

SUPREME COURT OF THE UNITED STATES

No. 73-593

CENTRAL TABLET MANUFACTURING CO.

v.

THE UNITED STATES

Order allowing certiorari. Filed December 17, 1973.
The petition for a Writ of Certiorari is granted.

Supreme Court of the United States

No. 73-593

Central Tablet Manufacturing Co.,

Petitioner,

v.

United States

ORDER ALLOWING CERTIORARI. Filed December 17 ----------, 19 73.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth ----------Circuit is granted.

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IN THE

Supreme Court of the United States

No.

OCTOBER TERM, 1973

CENTRAL TABLET MANUFACTURING CO.,
Petitioner,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI

**To The United States Court of Appeals
For the Sixth Circuit**

The Central Tablet Manufacturing Co., Petitioner, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion and order of the District Court for the Southern District of Ohio (Appendix A, *infra*, p. 11) is reported at 338 F. Supp. 1134. The opinion of the Court of Appeals for the Sixth Circuit (Appendix B, *infra*, p. 22) is reported at 73-2 USTC, ¶9545.

JURISDICTION

The judgment of the Court of Appeals was entered on July 12, 1973 (Appendix C, *infra*, p. 31). The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

The question presented is whether proceeds from disputed fire insurance claims accepted and paid by insurers to taxpayer after adoption by taxpayer of a plan of complete liquidation are entitled to the application of the nonrecognition of gain or loss provisions of Section 337 (a) of the Internal Revenue Code of 1954, where the fire giving rise to the insurance claims occurred before adoption of the plan of liquidation.

STATUTE WHICH CASE INVOLVES

Internal Revenue Code of 1954 (26 U.S.C. §337):

§337 Gain or loss on sales or exchanges in connection with certain liquidations.

(a) General rule.—if—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

STATEMENT OF THE CASE

Taxpayer was an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items in Columbus, Ohio. On September 10, 1965, an accidental fire largely destroyed its equipment, machinery and buildings. The buildings of taxpayer were never rebuilt or repaired and the manu-

facturing equipment was never replaced or repaired following the fire.

At the time of the fire taxpayer carried fire and extended coverage insurance on its buildings and machinery, and business interruption insurance. Negotiations of taxpayer's claim for business interruption loss began on approximately October 8, 1965. Negotiations of the claims for building and equipment and personal property losses began on approximately November 1, 1965. Disputes arose regarding the applicability of a co-insurance clause contained in the building insurance policy, the extent of building loss, the value of the building at the time of loss, the value of the machinery and equipment that was lost or damaged, and the cost of repair of repairable machinery and equipment. On May 14, 1966, the shareholders of taxpayer adopted a plan of dissolution and complete liquidation. On approximately May 20, 1966, taxpayer accepted a settlement of its building insurance claim which was paid to it on or about June 15, 1966. On approximately August 25, 1966, taxpayer accepted a settlement of its personal property insurance claim, which was paid to it on or about November 17, 1966.

On May 3, 1967, all remaining assets after liquidating distributions to shareholders were transferred to a national bank as trustee to meet claims against taxpayer and taxpayer was dissolved under Ohio law.

Taxpayer's business interruption loss claim was settled on or about August 25, 1967, and received on or about September 22, 1967.

Claiming the application of Section 337 (a) of the Internal Revenue Code of 1954, taxpayer did not report the gain realized (the difference between the basis of its assets and the amount of insurance received) upon the in-

voluntary conversion of its property as a result of the fire on September 10, 1965. The Commissioner determined that §337 was inapplicable because the fire occurred before adoption of the plan of liquidation and made a deficiency assessment against taxpayer for additional tax as a result of the gain realized from the involuntary conversion.

Taxpayer paid the additional tax and filed a claim for refund which was disallowed. Thereafter, an action was filed in the District Court for the Southern District of Ohio, under 28 U.S.C. §1346 (a), for recovery of the additional tax. The District Court held that the realized gain from this involuntary conversion was within the nonrecognition provisions of §337 and entered judgment for taxpayer. The Government appealed and the Court of Appeals reversed.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Is In Direct Conflict With The Decision Of The Eighth Circuit Court of Appeals In United States v Morton.[1]

In *United States* v *Morton*, it was held that fire insurance proceeds received after adoption of a plan of liquidation from a fire occurring before adoption of the plan constituted a nonrecognizable gain under §337.[2] The *Morton* decision was followed in *Kinney* v *United States*, 73-1 USTC, ¶9140 (No. Dist. Cal. 1972).[3] In the instant

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[1] 387 F. 2d 441 (8th Cir. 1968).

[2] The full important of *Morton* is that a "sale or exchange" by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. (387 F. 2d 447, 448)

[3] In *Kinney*, the court reasoned that the involuntary conversion did not occur until the insurer's receipt and acceptance of the proof of loss which postdated the adoption of the liquidation plan.

case, however, the Sixth Circuit Court of Appeals declined, expressly, to follow *Morton* (Appendix p. 26).

In addition to being raised in *Morton* and *Kinney* and in this case, the question of the applicability of §337 to an involuntary conversion brought about by a casualty occurring before adoption of a plan of liquidation is raised in at least three cases pending at the administrative level.[4] Moreover, because of the not uncommon occurrence of the events giving rise to the question and the normally significant tax sums which are in the balance, the question will continue to be litigated until the conflict is resolved by this Court. And certainly, neither the cause of efficient tax administration or the cause of improved judicial function will be served by permitting the separate development of case law within each of the eleven circuits—particularly, where, as here, a narrow issue of law, alone, is presented. Indeed, it is precisely in this type of situation that duplicative, expensive and needless future litigation can be prevented by timely review by this Court.

In summary, the recurrent nature of the question presented and its importance from the standpoint of both the number of taxpayers affected and the tax amounts involved—as well as the conflict which has been created—are circumstances which ought to impel this Court to a prompt review of the decision below.

2. The Court Below Erred In Holding That For The Purposes Of The Operation Of §337 The Gain From An Involuntary Conversion Of Property By Casualty Occurs At The Time Of The Casualty.

[4] The cases are *Fisher Baking Company* (L-191-A Code 411) pending before the District Director of Internal Revenue Salt Lake City, Utah; *Estate of Max Goldberg* (L-197B Code 430), pending before the District Director of Internal Revenue, Indianapolis, Indiana; *James F. White, Transferee of the Assets of Floyd Dugan Chevrolet, Inc., Toledo, Ohio*, pending before District Director of Internal Revenue, Cleveland, Ohio.

The enactment of §337 followed the decisions by this Court in *Commissioner of Internal Revenue* v *Court Holding Co.*, 334 U.S. 331 (1945)[5] and *United States* v *Cumberland Public Service Co.*, 338 U.S. 451 (1950),[6] and was intended to eliminate formalistic differences in distributions to shareholders in corporate liquidations as the basis for taxing both a corporation and its shareholders or just the shareholders for substantially the same gain producing transaction.

Prior to the decision in *United States* v *Morton, supra*, on the question that is in issue here, it had been held in *Dwight* v *United States*, 328 F. 2d 973 (2nd Cir. 1964) (involuntary conversion by condemnation) and in *Towanda Textiles, Inc.* v *United States*, 180 F. Supp. 373 (Ct. of Cl. 1960) (involuntary conversion by casualty) that an involuntary conversion of property into money was encompassed within the language "sale or exchange" as used in §337.[7] The Internal Revenue Service has acquiesced in this view—Rev. Rul. 64-100.

In the case at bar, the Sixth Circuit of Appeals seemingly[8] accepted the proposition that an involuntary conversion by casualty is to be treated as a "sale or exchange" under §337, but held, contrary to *United States* v *Morton*, that the involuntary conversion occurred at

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[5] Holding the gain from the sale of the single asset of a corporation by its two stockholders following transfer of the asset to them in liquidation was taxable to the corporation.

[6] Holding gains from sales by stockholders of property received in a general liquidation distribution were not taxable to the corporation.

[7] In *Kent Manufacturing Corporation* v *Commissioner*, 288 F. 2d 812 (4th Cir. 1961) it was held that a "sale or exchange" for the purposes of the operation of §392 (§§392 and 337 differ principally with respect to the period to which they are applicable) included involuntary conversions of property by casualty.

[8] While not rejecting outright the rule of the earlier cases and Rev. Rul. 64-100—that an involuntary conversion by casualty constitutes a "sale or exchange" for the purposes of §337—this is largely the end result of holding, in effect, that the conversion and casualty are one and the same.

the time of the casualty—in this case a fire which occurred before adoption of the plan of dissolution.

The majority[9] seems to have been persuaded to its judgment by the nonjuristic Government argument that the holding in *Morton* gives an advantage to a corporate taxpayer whose property is destroyed by casualty by permitting it to decide whether to rebuild or to liquidate[10] (Appendix p. 30). It is submitted, respectfully, that the opinion of the majority shows only a superficial consideration of the question involved and that its judgment is in error.

Admittedly, an involuntary conversion is not literally a sale or exchange. There are, however, features common to all three transactions, such that tests or standards for determining when a sale or exchange occurs for the purpose of the operation of §337 are meaningful in determining when an involuntary conversion occurs. Significantly, Treas. Reg. §1.337-2(a) provides:

> "Provided the other conditions of section 337 are met, sales or exchanges which occur on or after the date on which the plan of complete liquidation is adopted and within the 12-month period thereafter are subject to the provisions of such section. The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances. In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded.

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[9] Judge Kent who was on the panel that heard this case died before it was decided and did not participate in the decision.

[10] The argument is not sound even on this basis; a sale, for instance, can be negotiated before a plan of dissolution is adopted and still be entitled to non recognition (Treas. Reg. §1-337-1(a), *infra*).

> Moreover, an executory contract to sell is to be distinguished from a contract of sale. Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional."

This is also the rule under taxing statutes generally. See *Lucas* v *North Texas Lumber Company*, 281 U.S. 11 (1930); *United States Industrial Alcohol Co.* v. *Helvering*, 137 F. 2d 511 (2nd Cir. 1943).

Involuntary conversion by condemnation is held, uniformly, to occur when title passes to the condemnor under applicable state or federal law.[11] *West Street-Erie Boulevard Corporation v United States*, 411 F. 2d 738 (2nd Cir. 1969); *Covered Wagon, Inc.* v *Commissioner*, 369 F. 2d 629 (8th Cir. 1966); *The Mountain Water Co. of La Crescenta* v *Commissioner*, 35 TC 418 (1960).

In both situations the transaction is held to occur, for the purpose of the application of §337, at that point at which the obligations and rights of the parties become unconditional (in a sale when an unconditional contract is entered into by the parties; in a condemnation when title passes to the condemnor). By a parity of reasoning, an involuntary conversion by casualty of insured property cannot have occurred until some right, at least, to insurance proceeds is agreed upon or otherwise established. And certainly this is not, as this Court of Appeals would have it, at the time of the casualty in every case.[12]

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[11] Under some state statutes this may be at the time of the verdict or award. Opinion No. 3068, Opinions of the Attorney General of Ohio, 1962. A summary of state laws on this point is found in 26 Am. Jur 2d, Eminent Domain §131, p. 790.

[12] In the instant case the original proofs of loss were rejected out of hand by the insurance carriers and prolonged argument was waged as to both the extent of coverage under the policies (a dispute existed over the efficacy of a co-insurance clause) and the amount of damage.

In *United States* v *Morton*, the court held:

> "In any sale or exchange something of value is received for the article sold or exchanged. Usually in a sale the consideration is money which is readily and presently available for use by the holder or else comparable property which is of immediate benefit to the holder. The mere conversion of a tangible capital asset into a chose in action against an insurance company for an undetermined amount is not a completed 'sale or exchange'. Collection is predicated upon compliance with policy conditions, which uniformly require a proof of loss and the allowance of a period of time within which the insurance company may make its investigation before suit may properly be instituted. It would thus appear that the 'sale or exchange' by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. There certainly can be no gain to recognize until the amount of the proceeds is determined and made available. Under this reasoning the 'sale or exchange' would not take place in the case at bar until, at least, December 19, 1960 when the offer of the insurers in settlement of the claims resulting from the fire loss was accepted. Therefore, any gain resulting from the collection of the insurance proceeds would be entitled to nonrecognition under §337." (387 F. 2d 447)

In *Kinney* v *United States*, 73-1 USTC, ¶9140, the court concluded, at page 80, 131:

> "* * * The same reasoning [the reasoning of the condemnation cases that upon passage of title an enforceable right to an exact award comes into being] supports the result reached in this case, an involuntary loss case, since no right to proceeds exists prior to the insurer's receipt and acceptance of the proof

of loss, which postdated the adoption of the plan [of dissolution]."

By analogy, the involuntary conversion of property in this case did not occur before determination or agreement as to the extent of coverage under the insurance policies, which occurred after adoption of the plan of dissolution, and the Court of Appeals incorrectly held that the non-recognition of gain provisions of §337 are unavailable to this taxpayer.

CONCLUSION

Unless promptly resolved by this Court, the conflict between the decision of the Court of Appeals in this case and the decision in *United States* v *Morton*, 387 F. 2d 441 (8th Cir. 1968), will produce a multiplicity of administrative proceedings and court cases. For this reason and because of the importance of the tax question involved the petition for a writ of certiorari should be granted.

Respectfully submitted

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October __, 1973

APPENDIX A

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISION

CENTRAL TABLET MANUFACTURING COMPANY,
Plaintiff

v.

UNITED STATES OF AMERICA,
Defendant

Civil No. 69-116

OPINION AND ORDER

This action, brought pursuant to Title 28 U.S.C. §1346(a)(1) to recover taxes alleged to have been erroneously collected, comes before the Court for final decision on the stipulations of fact, exhibits, and briefs of the parties.

The uncontested facts in this case are as follows: Plaintiff, Central Tablet Manufacturing Company (hereinafter Central Tablet) was for many years prior to May 14, 1966, an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items at its place of business in Columbus, Ohio. On August 13, 1965, a majority of Central Tablet's production and maintenance employees went on strike, thereby reducing production to approximately 5% of normal volume. On September 10, 1965, during the course of this strike, an accidental fire largely destroyed Central Tablet's equipment, machinery and building, none of which was subsequently repaired or replaced.

The strike was never settled and Central Tablet never again engaged in manufacturing.

As of September 10, 1965, the plaintiff carried fire and extended coverage insurance on its buildings, machinery and inventory. It also carried business interruption insurance. The stated dollar limit of liability on the building was $225,000 under three separate policies of $75,000, which were identical except for the insurer. The stated dollar limit of liability on the machinery and inventory was $450,000 under one policy. The stated dollar limit of liability for business interruption was $100,000 under two policies identical except for the insurer.

Negotiation of Central Tablet's claim for business interruption loss began on approximately October 8, 1965. Disputes arose between Central Tablet and its insurers as to the estimated period of loss to be covered by business interruption insurance and as to the probable duration of the strike had there not been a fire, for the purpose of determining the "actual loss sustained" by Central Tablet during the period of loss covered under the insurance policies. No settlement on this claim was negotiated until August 25, 1967, and on or about September 22, 1967, Central Tablet received $67,000 in payment of its loss.

Negotiations of Central Tablet's insurance claims for building, machinery and personal property losses began on approximately November 1, 1965. Dispute arose regarding the applicability of a co-insurance clause contained in the building insurance policy, the extent of building loss, the value of the building at the time of the loss, the value of the machinery and equipment that was lost or damaged and the cost of repair of repairable machinery and equipment. Central Tablet accepted a settlement of its building insurance claim on approxi-

mately May 20, 1966, and on June 15, 1966, received $174,595.05 in payment thereof. On approximately August 25, 1966, Central Tablet accepted a settlement of its personal property claim and on or about November 17, 1966, received $104,609.27 in payment thereof.

On May 14, 1966, before the corporation had settled any of its claims or received any insurance funds, the shareholders of Central Tablet held a special meeting pursuant to notice, elected to dissolve the corporation and adopted a plan of dissolution and complete liquidation. A certified copy of the Resolution of Stockholders and Plan of Dissolution (see Exhibit 4) was filed with the Cincinnati District Director of Internal Revenue on May 25, 1966. On May 3, 1967, all remaining assets, after liquidating distributions to shareholders, were conveyed to the Ohio National Bank of Columbus, Ohio, in trust for the shareholders pending the complete winding-up of the corporation's affairs, including the payment of taxes and the collection of its insurance and other claims.

I

THE APPLICABILITY OF SECTION 337

The primary question presented for decision is whether the plaintiff's gain from the involuntary conversion of its building, machinery and inventory is exempt from taxation by reason of Section 337(a) of the 1954 Internal Revenue Code, 26 U.S.C. §337(a).[1] The District Director,

[1] §337. *Gain or loss on sales or exchanges in connection with certain liquidations*

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

electing not to follow the decision of the Eighth Circuit Court of Appeals in *United States* v. *Morton*, 387 F.2d 441 (1968), concluded that such gain was taxable and assessed deficiencies against plaintiff in the amount of $70,051.30 for its tax year on October 31, 1965, and $11,930.30 for its 1963 tax year.[2] We conclude that the assessments made by the Director were erroneous in part, and we therefore grant partial judgment for the plaintiff.

The primary object of Section 337 of the Internal Revenue Code was remedial. First, the section intended to eliminate double taxation on the same gain, resulting when a corporation decides to liquidate and thereafter distributes its assets to shareholders themselves subject to taxation. See, *Morton* v. *United States, supra; Pridemark, Inc.* v. *C.I.R.*, 345 F.2d 35 (4th Cir. 1965); *West Street-Erie Boulevard Corp.* v. *United States*, 411 F.2d

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[2] Such assessment was based upon the inclusion by the District Director of the following sums received by plaintiff from fire and business interruption insurance:

1. *Taxpayer's 1967 tax year*
   (a) $223,669.00 (the excess of fire insurance proceeds over net book value, plus $4000.00 in legal fees, assigned as a cost of the sale) received after the adoption of a complete plan of liquidation and distribution within a 12-month period following the date of adoption, in accordance with Section 337. This sum was treated by the Director as a long-term capital gain in the year ending October 31, 1965.
   (b) $12,992.00, representing the pro-rata part of $67,000.00 business interruption insurance proceeds which accrued to it in the year ending on October 31, 1967.
   (c) $20,764.00, representing that part of the total proceeds from fire insurance to be treated as ordinary income resulting from depreciation, within the meaning of Section 1245, Internal Revenue Code of 1954. For a discussion of this assessment, see Part II of this opinion, *infra*.
2. *Taxpayer's 1963 Tax Year*
   (a) $54,008.00, representing the pro-rata portion of the $67,000.00 proceeds from business interruption insurance which accrued to plaintiff in its 1966 tax year (resulting in a decrease in plaintiff's operating loss carryback to 1963).
   (b) The disallowance as an expense in the year ending October 31, 1966, of legal fees in the amount of $4000.00, paid by plaintiff during that year for services rendered in the negotiation and adjustment of the insurance losses.

738 (2d Cir. 1969). Second, the section was promulgated to resolve the conflict created by disparate holdings in *Internal Revenue* v. *Court Holding Co.*, 324 U.S. 331 (1944) and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), and to eliminate technical distinctions based upon the form of corporate dissolution created by these cases. See, *United States* v. *Morton, supra*, 367 F.2d at 444. The thrust of Section 337 is thus to create a rule of exemption which is understandable and easy to apply.

Difficulties of application have arisen, however, as a result of the Court of Claims' holding in *Towanda Textiles* v. *United States*, 180 F.Supp. 373 (1930), a case which established the principle that an involuntary conversion of corporate assets by accidental fire constitutes a "sale or exchange" of property, within the meaning and purpose of Section 337(a). The question which has been raised is this: At what point of time, for tax purposes, should such sale or exchange be deemed to take place? At the time of the involuntary conversion itself? At the time the taxpayer receives proceeds from the conversion? Or at the time that the right to receive proceeds becomes fixed and determinable? The Court in *Towanda Textiles* was not faced with this precise question, since in that case both the fire itself and the realization of proceeds from fire insurance occurred after a plan of liquidation had been adopted and within the 12-month period contemplated by the statute.

The precise question was raised and adjudicated in *Morton* v. *United States*, 258 F.Supp. 922 (W.D. Missouri 1961), the Missouri court holding:

> "In order to carry out the clear intent of Congress in enacting §337, that an involuntary conversion *followed by* adoption of a plan of complete liquida-

> tion by a corporation and the completion thereof within 12 months of its adoption, likewise comes within the intent of Congress when it exempted the corporation from liability for a tax on the gain derived from a sale on its property in liquidation."

In a lengthy and well-reasoned opinion, this holding was sustained by a unanimous Court in *United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968). The Court rejected as unpersuasive the Government's argument that conversion by fire is similar for tax purposes to a conversion by condemnation, where, depending on State law, the simple filing of a condemnation proceeding may give rise to a taxable gain to the condemnee. See, e.g., *Covered Wagon, Inc.* v. *Commissioner*, 369 F.2d 629 (8th Cir. 1966); *Wendell* v. *Commissioner*, 326 F.2d 600 (2d Cir. 1964). Unlike condemnation, the Court concluded, where a conclusive, constitutional right to compensation is vested in the condemnee on the date of the taking, a fire:

> "is but the commencement of an involuntary conversion that does not come into fruition until, at least, the amount to be received by way of reimbursement for that loss is decided either by agreement or by court action . . .
>
> "The mere conversion of a tangible capital asset into a chose in action against an insurance company for an undetermined amount is not a completed 'sale or exchange.' Collection is predicated upon compliance with policy conditions, which uniformly require a proof of loss and the allowance of a period of time within which the insurance company may make its investigation before suit may be properly instituted. It would thus appear that the 'sale or exchange' by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. There certainly can

> be no gain to recognize until the amount of the proceeds is determined and made available. . . . Therefore, any gain resulting from the collection of the insurance proceeds would be entitled to nonrecognition under §337." 387 F.2d at 447, 448.

The Court concludes that the reasoning and conclusions of *Morton* are persuasive. We adhere to its holding.

The Government asserts, however, that *Morton* is distinguishable from the present case, inasmuch as the claimant there was a cash basis taxpayer whereas the plaintiff here utilizes an accrual method of accounting. In addition, the Government has attempted to show, by way of deposition, that the fact of liability was never put in issue by taxpayer's insurance adjusters, although the amount of liability was subject to negotiation. Thus, the argument goes, this taxpayer's right to receive insurance proceeds became fixed before its plan of corporate liquidation was adopted; that is, at the time of the fire, or as soon thereafter as it became apparent that the insurers' basic liability was not to be contested.

On its surface and applied to the facts of this case, this argument lacks plausibility. In general, under the accrual method of accounting, it is the right to receive income, and not the actual receipt thereof which gives rise to taxation. Income is realized by an accrual taxpayer when his right to receive it becomes fixed and its measure does not depend on future events or contingencies, even though the exact amount may not be determined until later. See, *Cappel House Furnishing Co.* v. *United States*, 140 F.Supp. 92 (S.D. Ohio 1956), *aff'd.* 244 F.2d 525 (6th Cir. 1957); *Ohmer Register Co.* v. *Commissioner*, 131 F.2d 682, 686 (6th Cir. 1942). See also, *Continental Tie and Lumber Co.* v. *United States*, 286 U.S. 290 (1932).

In insurance accrual cases, it has been held that the right to proceeds does not become fixed until there is an unqualified recognition of liability by the obligor. See, generally 2 Mertens, Law of Federal Income Taxation, §12.61 (1967 Rev.); *Maryland Shipbuilding and Drydock Co.* v. *United States*, 409 F.2d 1363 (Ct. Cl. 1969). Furthermore, the amount to be received must be susceptible to calculation; i.e., the taxpayer must have on its own books and accounts some data by which he can reasonably estimate the *quantum* of the sum to be received, if it is to give rise to taxable income. See *Continental Tie & Lumber Co., supra*, 286 U.S. at 296; *Cappel House Furnishing Co., supra*, 244 F.2d at 530. As *Cappel House* recognizes, the vice to be prevented is the forestalling or avoidance of taxation through the simple device of delaying computation of income, the right to which has become fixed and which is reasonably estimable. *Id*, at 530.

The facts of the present matter, taken as a whole, distinguished it from *Cappel House, supra*. At no time was an express admission of liability made by taxpayer's insurance adjusters. Indeed, there is some evidence in the record that the insurance companies denied that notice of claim was properly given by plaintiff. And even if it were possible to conclude that liability was at some point impliedly admitted, there is insufficient evidence in the record to determine at what point in time such admission occurred.

Negotiations between plaintiff and agents of the insurance companies took place over an extended period of almost two years. Involved in these negotiations were three separate insurance contracts, at least two of which were exceedingly complex and difficult to apply under

the circumstances of the case. Disputes occurred over such matters as the applicable period of coverage, the projected length of the strike, and the repairability and valuation of damaged machinery. In one instance, with regard to plaintiff's property insurance claim, questions arose as to the applicability of a co-insurance clause, which if found to be applicable, would have reduced plaintiff's coverage by 43%.[3] In each case, substantial discrepancies existed between the initial offers made by the insurance companies, the maximum permissible insurance coverage, and the amounts ultimately negotiated. And, although dollar amounts were finally (and somewhat arbitrarily) agreed upon, the parties were evidently unable to resolve many of their differences in interpreting the scope of coverage.

Under all of the above circumstances, it would be an utter fiction for us to conclude that the taxpayer realized fixed and estimable income before it adopted a plan of liquidation on May 14, 1966. While there are instances in which double taxation may result from the operation of law, it is not the considered policy of this Court to seek out situations in which to impose a double tax. Accordingly, the Court holds that Central Tablet was entitled to Section 337 non-recognition of gains realized from insurance proceeds and is entitled to a refund of taxes thereon which have been erroneously collected.

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[3] It has been held, even where the amount of insurance loss has been fully adjusted, that accrual of insurance proceeds is not required until the insurer has formally waived co-insurance requirement affecting part of the claim. See, e.g., *Georgia Carolina Chemical Co.*, 3 Tax Ct. 1213, 1216 (1944).

II

THE SECTION 1245 INCOME

Pursuant to Section 1245 of the Internal Revenue Code,[4] 26 U.S.C. §1245, the District Director assessed a tax on $20,764.00 of property and building insurance proceeds, representing ordinary income received by taxpayer from the recapture of depreciation. The parties are in agreement that Section 1245 overrides the nonrecognition provisions of Section 337 and have stipulated that the above amount is subject to taxation. The only question presented is whether such proceeds were taxable in plaintiff's 1965 tax year, as assessed by the District Director, or in plaintiff's 1966 tax year, as contended by the plaintiff.

For reasons fully and adequately stated in Part I of this Opinion, the Court holds that plaintiff's gain from the involuntary conversion of Section 1245 property did not accrue until it settled its claim in 1966 and received monies in payment of building and property losses. Accordingly, plaintiff is entitled to a refund of the tax assessed in 1965.

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[4] §1245. *Gain from disposition of certain depreciable property*

(a) General rule.—

(1) Ordinary income.—Except as otherwise provided in this section, if section 1245 property is disposed of during a taxable year beginning after December 31, 1962, the amount by which the lower of—

(A) the recomputed basis of the property, or

(B) (i) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) in the case of any other disposition, the fair market value of such property, exceeds the adjusted basis of such property shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. *Such gain shall be recognized notwithstanding any other provisions of this subtitle.* [emphasis added]

III

LEGAL FEES AS A CAPITAL EXPENDITURE

Central Tablet took as an ordinary income deduction for tax years 1966 and 1967, $4,000.00 for legal fees attributable to negotiations and settlement of the insurance loss. It used its 1966 deduction to increase its operating loss carryback for the 1963 tax year. See note 2, *supra*. The District Director disallowed these deductions, treated them as capital expenditures, and assessed deficiencies against the taxpayer. Since plaintiff now concedes that the District Director's assessment was correct, we find it unnecessary to consider this question. But see, *Lanrao, Inc.* v. *United States*, 288 F.Supp. 464 (E.D. Tenn. 1968), *aff'd. per curiam*, 422 F.2d 481 (6th Cir. 1970).

WHEREFORE, it is the finding of this Court that deficiency assessments entered by the Internal Revenue Service against the plaintiff were erroneous as a matter of law and that plaintiff is entitled to a refund for its 1963 and 1965 tax years. Judgment is hereby entered in plaintiff's behalf for $81,981.60, less an amount representing the tax difference between ordinary income deduction and the capital expenditure deduction on $8,000.00. This latter figure, and the final judgment award, shall be computed by the defendant, approved by the plaintiff, and forwarded to the Court, within twenty (20) days of receipt of this Opinion.

It is so ORDERED.

CARL B. RUBIN
United States District Judge

APPENDIX B

No. 72-1582

UNITED STATES COURT OF APPEALS
For The Sixth Circuit

CENTRAL TABLET MANUFACTURING COMPANY, *Plaintiff-Appellee,* v. UNITED STATES OF AMERICA, *Defendant-Appellant.*	ON APPEAL from the United States District Court for the Southern District of Ohio, Eastern Division.

Decided and Filed July 12, 1973.

Before: McCREE and KENT*, Circuit Judges, and McALLISTER, Senior Circuit Judge.

McCREE, Circuit Judge. Section 337[1] of the Internal Revenue Code of 1954, as amended, has been judicially interpreted to provide for nonrecognition of a capital gain realized by a corporate taxpayer upon receipt of fire insurance proceeds paid after the destruction of property, if both the fire and payment occur within a 12-month period after the adoption of a plan of complete liquidation. This appeal requires us to determine whether the involuntary conversion (which equates with a sale or exchange of the property for purposes of §337) occurs

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* Judge Kent died on May 28, 1973 and did not participate in this decision.

[1] The pertinent portion of §337 is as follows:

§337. Gain or loss on sales or exchanges in connection with certain liquidations

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

when the property is destroyed or when the policy proceeds are received because this taxpayer adopted a plan of complete liquidation after a fire but before receipt of the insurance proceeds. In an action for refund of $81,732.39 in taxes paid under protest, the district court determined that the involuntary conversion did not occur until the insurance proceeds had been paid. We hold that the conversion took place at the time the property was destroyed and reverse the judgment of the district court.

Appellee Central Tablet Manufacturing Company was an Ohio corporation with offices and manufacturing facilities in Columbus, Ohio. Until 1965 it employed a sizable labor force and was a profitable manufacturer of writing tablets, school supplies, art materials, and related articles. An August 13 of that year, taxpayer's production and maintenance employees went on strike. While the strike was in progress, an accidental fire on September 10, 1965, extensively damaged or destroyed the greater part of appellee's equipment, inventory, and building. Taxpayer, at the time of the fire, carried both fire and business interruption insurance, and timely notified the insurance carrier of the loss.

Although the insurance carrier questioned neither the validity of the insurance contracts nor the fulfillment of the conditions for payment thereunder,[2] it did dispute the amount to be paid under each policy.[3] Negotiations between the taxpayer and the insurer began on Novem-

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[2] Mr. James A. Wroe, the insurance adjuster assigned to this case, testified that "it was obvious that there was a fire. It was in progress when I was first on the scene. Now, liability is not a factor there. I mean, the contract provides the coverage for fire, and what remains then, is to establish the extent of damage." He then testified that neither he nor the insurer ever challenged or considered challenging the insurance coverage in this case because there was no sign of arson.

[3] The insurer asserted the applicability of a coinsurance clause in the fire policy on the building, and challenged the company's valuation of the building and machinery at the time of loss and the cost of repair of the few repairable pieces of machinery.

ber 1, 1965, to adjust the payments due under each policy. These efforts culminated in an agreement on the building claim on May 20, 1966 and on the personal property and other claims on August 25 of the same year.[4] However, on May 14, 1966, six days before the first settlement and a full nine months after the fire, the shareholders of Central Tablet voted to dissolve the corporation and to liquidate its assets. Within the succeeding year, all corporate assets were collected, debts were paid, liquidating distributions were made to the shareholders, and, on May 3, 1967, a reserve was deposited in trust for the shareholders in the Ohio National Bank of Columbus, Ohio to await payment of final debts in completion of the liquidation.

As an accrual-basis taxpayer, appellee treated the gain realized from the fire insurance proceeds as nonrecognizable under IRC §337. However, the Commissioner of Internal Revenue determined that the taxpayer had not qualified for this treatment because the shareholder liquidation vote came after the fire, which the Commissioner regarded as the time of conversion and thus of the "sale or exchange" to which §337 refers. The taxpayer paid the deficiency assessed by the Commissioner and initiated a timely refund suit in the district court.

The district court, recognizing that this Circuit had not previously decided when an involuntary conversion occurs for purposes of §337, followed the holding of the Eighth Circuit in *United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968), and entered judgment in favor of the taxpayer. The Government has appealed.

It is important at the outset to comment upon an uncontested issue. The Government does not now contest

[4] Payment for the building claim was made on June 15, 1966, in the amount of $174, 595.05 and for the personal property claim on November 17, 1966, in the amount of $104,609.27.

the treatment of a fire loss as a "sale or exchange" under §337, although this is contrary to its position prior to 1964. Shortly after the passage of the Internal Revenue Act of 1954, the Commissioner of Internal Revenue, through Rev. Rul. 56-372, flatly stated that a casualty loss was not a sale within the meaning of §337.[5] This position was vigorously and consistently, although unsuccessfully, advocated before the court of claims[6] and the Fourth Circuit.[7] But in 1964, in Rev. Rul. 64-100, the Commissioner finally capitulated to the weight of mounting authority by revoking Rev. Rul. 56-372 and adopting the prevailing judicial view.[8]

The sole issue before us is on what date, for purposes of §337, does the involuntary conversion that equates with the "sale and exchange" occur when insured capital assets are destroyed by fire. For the reasons hereinafter stated, we hold that the date the fire occurs is the date on which the conversion takes place for purposes of determining the applicability of §337. Accordingly, since the appellee failed to adopt a plan of liquidation before the fire occurred, it does not qualify for nonrecognition of the gain from insurance proceeds.

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[5] "Accordingly, it is held that the receipt of fire insurance proceeds from the complete destruction of a building by fire, resulting in an involuntary conversion, does not constitute a 'sale' for the purpose of obtaining nonrecognition of gain or loss benefits where liquidation of corporate assets is made pursuant to section 337(a) of the Internal Revenue Code of 1954." Mertens, *Law of Federal Income Taxation*, 1954-57 Rulings 389 (1958).

[6] *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp 373 (Ct. Cl. 1960).

[7] *Kent Manufacturing Corp.* v. *Commissioner*, 288 F.2d 812 (4th Cir. 1961).

[8] Consistent with the *Towanda Textiles, Inc.* and *Kent Manufacturing Corporation* decisions, conversions of property of the type described in section 337 of the Code will be treated as sales or exchanges for purposes of that section, where such conversions result in loss as well as gain, regardless of whether such property is the type described in section 1231 of the Code and regardless of whether such property has been held for more than six months." Mertens, *Law of Federal Income Taxation*, 1961-65 Rulings 636 (1966).

The taxpayer insists that in this case, the involuntary conversion by fire that equates with a sale or exchange did not occur until the insurance proceeds were finally paid. He relies on *United States* v. *Morton, supra.* The Government, on the other hand, contends that the date of the fire should be regarded as the date of "sale."

We respectfully decline to follow *Morton.* In that case the Eighth Circuit analogized the involuntary conversion to a commercial sale where "the consideration is normally money which is readily and presently available for use by the holder or else comparable property which is of immediate benefit to the holder." 387 F.2d at 447-8. It determined that the "sale" could only be concluded when the taxpayer could specifically quantify the consideration it would receive, either by judgment or agreement. *Id.* However, this view misapprehends the purpose of §337.

The legislative history indicates that §337 was enacted to establish an easy-to-follow and well-defined corporate procedure by which the capital gains realized in liquidation sales would not be taxed to the corporation, but only to the shareholders upon distribution to them of the proceeds as liquidating dividends. In the ten years preceding the adoption of the Internal Revenue Act of 1954, two Supreme Court cases created considerable confusion concerning the way in which a corporation could escape taxation of gains under IRC §22(a) (1939), from the sale of all its assets after a decision to liquidate the business. In *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), the Supreme Court upheld the tax court's determination that the corporation's breaking off negotiations to sell its only asset, an apartment building, and its subsequent conveyance of the building as a liquidating dividend to its sole shareholders, a husband and wife, who later sold it to the same persons with whom the

corporation had been negotiating and reduced the sale price by the $1,000 down payment given to the corporation, "showed a sale by the corporation rather than by the shareholders . . . ." 324 U.S. at 332. Although the court of appeals had reversed the tax court because it drew different inferences from the undisputed facts, Justice Black, in reiterating that findings of the tax court are binding on appellate courts, reasoned that

> [t]he incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. . . . To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress. 324 U.S. at 334.

Five years later in *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), Justice Black, again speaking for the majority, this time upheld a court of claims determination that the corporation's shareholders had properly negotiated the sale of corporate assets distributed to them in kind in a partial liquidation without incurring the corporate tax liability of IRC §22(a).

Although different outcomes resulted, there are many similarities in the two cases. In both *Court Holding* and *Cumberland*, the objective was the same: avoidance of corporate taxation. There was an offer to buy made to each corporation before negotiations with the shareholders commenced. The corporate assets were distributed in kind to the shareholders in both instances. Both sets of

shareholders intended to sell the assets immediately upon receipt. Both sets of shareholders received all the proceeds of the sale.

The only significant difference appears to be that in *Court Holding*, the two shareholders were also the managing officers of the corporation and merely changed hats in negotiating with the same purchaser after the apartment building was deeded to them. In *Cumberland* there were shareholders in addition to those who retained managerial positions, and this fact arguably implies that activities of the managing shareholders during the initial negotiations served broader interests than those of the corporation alone.

But this theoretical difference ignores the practical control that relatively small numbers of shareholders in closely held corporations exercise over corporate decision-making. Such a tenuous difference should not justify denying nonrecognition to one closely held corporation and granting it to another when the shareholders of both corporations have the same motives and exercise the same degree of effective control. These cases illustrate the difficulty of distinguishing between a sale by a corporation and a sale by its shareholders. Nevertheless, as Mr. Justice Black observed in *Cumberland*, the existing statutory scheme made such an inquiry necessary:

> The oddities in tax consequences that emerge from the tax provisions here controlling appear to be inherent in the present tax pattern. For a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet it is not taxed if that property is distributed in kind and is then sold by the shareholders. In both instances the interest of the shareholders in the business has been transferred to the purchaser. . . .
>
> Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation

> may dispose of corporate property, we accept its mandate.

338 U.S. at 455-6.

The Congress, four years later in the course of its revision of the entire tax code that resulted in the Internal Revenue Code of 1954, attempted to remedy this unsatisfactory situation. The House Committee resolved that, since ". . . under present law, the tax consequences arising from sales made in the course of liquidation depend primarily upon the formal manner in which transactions are arranged, . . . [y]our committee intends . . . to provide a definitive rule which will eliminate any uncertainty." 3 U.S. CODE CONG. & ADMIN. NEWS 1954, at 4244. The remedial rule enacted, §337(a), permitted only ". . . the imposition of a single tax at the shareholder level upon property sold during the course of a liquidation irrespective of whether the corporation or the shareholder in fact effected the sale . . . ." *Id.* at 4245. Even prior negotiations have no effect: "Since subsection (a) refers to 'a sale' the fact that negotiations have been commenced prior to sale is immaterial . . . ." *Id.* However, the statute clearly requires, as taxpayer concedes, the adoption of a plan of complete liquidation before the sale or exchange of property occurs. *See* note 1 *supra.*

It is clear, then, that Congress decided to grant nonrecognition treatment only to a corporation that had already decided to cease operations and liquidate. It eliminated the necessity of determining whether a sale of all the corporate assets by shareholders to whom the assets had been distributed as a liquidating dividend was, for tax purposes, a sale by the corporation. The judicial extension of the section to provide for nonrecognition of a gain when the assets are involuntarily converted either by destruction or condemnation was intended to prevent an injustice to shareholders who had adopted

a plan of liquidation but who thereafter lost their property by destruction or eminent domain before it could be sold. *See Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. Cl. 1960). To expand the statute further by construing it to permit nonrecognition when the property is destroyed before adoption of a plan of liquidation would, instead of preventing injustice to a taxpayer that had decided to liquidate, give it an advantage over other taxpayers by permitting it to decide after destruction of the property whether to rebuild with insurance proceeds or to liquidate. The Congress has provided relief for taxpayers who experience casualties and elect to use insurance proceeds to rebuild. Section 1033 provides for nonrecognition of gains from insurance proceeds if they are employed to replace the destroyed property within a stipulated time. We decline to read §337 to give the same relief to taxpayers who decide to retain the insurance proceeds and go out of business. Section 337 is a statute designed to prevent double taxation when a corporation is committed to liquidation, and was not intended to serve as a relief measure for taxpayers who by fortuity suffered a destruction of corporate assets and still realized a gain. We have recently reaffirmed in a case involving another nonrecognition statute the "well settled principle that statutes granting tax exemptions or deferments must be strictly construed," *Elam* v. *Commissioner of Internal Revenue*, No. 72-1836, at 3 (May 22, 1973), and in obedience to that principle we conclude that the sale or exchange experienced by appellee in this case occurred on the date when its property was destroyed.

Reversed and remanded for further proceedings consistent herewith.

APPENDIX C

UNITED STATES COURT OF APPEALS

For The Sixth Circuit

No. 72-1582

CENTRAL TABLET MANUFACTURING CO.,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before: McCREE, and KENT, Circuit Judges, and McALLISTER, Senior Judge.

JUDGMENT

APPEAL from the United States District Court for the Southern District of Ohio

THIS CAUSE came on to be heard on the record from the United States District Court for the Southern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and the case is remanded for further proceedings.

It is further ordered that Defendant-Appellant recover from Plaintiff-Appellee, the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

ENTERED BY ORDER OF THE COURT

Issued as Mandate: August 7, 1973 JAMES A. HIGGINS
COSTS: To be recovered by Appellant *Clerk*
Filing Fee . . . . . $_____ A True Copy.
Printing . . . . . $190.75 Attest:
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Total . . . . . .$190.75 *Clerk*

In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

CENTRAL TABLET MANUFACTURING CO.,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

Petitioner manufactured and sold educational and art supplies. On September 10, 1965, an accidental fire destroyed its equipment and building, none of which was subsequently repaired or replaced. The building and equipment were covered by fire and extended coverage insurance and petitioner timely notified its insurance carrier of the loss.

The insurance carrier did not question either the validity of the insurance contracts or the fulfillment of the conditions for payment. It did, however, dispute the amount to be paid under each policy. Negotiation of the claims for the building and equipment began on or about November 1, 1965. On May 14, 1966, petitioner's shareholders adopted a plan of dissolution and complete

liquidation pursuant to Section 337 of the Internal Revenue Code of 1954. Shortly thereafter, petitioner's claims with the insurance company were settled (Pet. App. B 23-24).

Petitioner realized a gain upon this transaction but excluded it from its taxable income on the ground that the gain was not recognizable under Section 337(a) of the Code. That provision permits a corporation to exclude gain from the sale or exchange of its property within the 12-month period after the adoption of a plan of complete liquidation. Since 1964, the Internal Revenue Service has ruled gains from involuntary conversion are entitled to the benefits of Section 337.[1] On audit, the Commissioner of Internal Revenue determined that the non-recognition provisions of Section 337 did not apply because the involuntary conversion of petitioner's property occurred upon its destruction, which was prior to the beginning of the prescribed 12-month period.

The district court upheld petitioner's claim for refund under Section 337, on the ground that the involuntary conversion of the property occurred upon agreement with the insurance carrier as to the amount of the insurance proceeds, which was within 12 months after the adoption of the plan of liquidation. In so holding, it followed the decision of the Eighth Circuit in *United States* v. *Morton*, 387 F. 2d 441, which is squarely in point (Pet. App. A 11-21). The court of appeals reversed, expressly declining to adopt the reasoning of *Morton* (Pet. App. B 22-30).

As petitioner states (Pet. 4-5), there is a conflict of decisions on the question whether, for purposes of

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[1] Rev. Rul 64-100, 1964-1 Cum. Bull. (Part 1) 130.

Section 337, an involuntary conversion occurs upon the destruction of the property or upon the agreement as to the amount of the insurance proceeds.[2] We therefore do not oppose the granting of the petition for a writ of certiorari.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1973.

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[2] We are advised by the Internal Revenue Service that the issue is presently pending at the administrative level in nine cases involving a total of $603,196 in taxes. It is also currently awaiting oral argument in the Ninth Circuit (No. 73-1384) on the government's appeal of *Kinney* v. *United States*, 73-1 U.S.T.C., par. 9140 (N.D. Cal.), involving a claimed refund of $13,413.62. While the Ninth Circuit has not yet scheduled argument in the case, it is expected that it will not be heard for at least six months.

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IN THE

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OCTOBER TERM, 1973

No. 73-593

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UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion and order of the district court in this case (R. 54)[1] is reported at 338 F. Supp. 1134. The opinion of the court of appeals (R. 57) is reported at 481 F. 2d 954.

JURISDICTION

The judgment of the court of appeals was entered on July 12, 1973 (R. 57). The petition for a writ of certiorari was filed on October 3, 1973, and certiorari was granted on December 17, 1973 (R. 58). The jurisdiction of this Court rests on 28 U.S.C. 1254 (1).

[1] "R" references are to the separately bound record appendix.

QUESTION PRESENTED

The question presented is whether proceeds from disputed fire insurance claims accepted and paid by insurers to taxpayer after adoption by taxpayer of a plan of complete liquidation are entitled to the application of the nonrecognition of gain or loss provisions of Section 337 (a) of the Internal Revenue Code of 1954, where the fire giving rise to the insurance claims occurred before adoption of the plan of liquidation.

STATUTE WHICH CASE INVOLVES

Internal Revenue Code of 1954 (26 U.S.C. §337):

§337 Gain or loss on sales or exchanges in connection with certain liquidations.

(a) General rule.—if—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

STATEMENT OF THE CASE[2]

Taxpayer was an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items in Columbus, Ohio. On September 10, 1965, an accidental fire largely destroyed its equipment, machinery and buildings. The buildings

[2] The facts contained in this statement may be found in the Statement Of Uncontested Facts And Of The Issues filed in the district court in this case (R. 31-36).

of taxpayer were never rebuilt or repaired and the manufacturing equipment was never replaced or repaired following the fire.

At the time of the fire taxpayer carried fire and extended coverage insurance on its buildings and machinery, and business interruption insurance. Negotiations of taxpayer's claim for business interruption loss began on approximately October 8, 1965. Negotiations of the claims for building and equipment and personal property losses began on approximately November 1, 1965. Disputes arose regarding the applicability of a co-insurance clause contained in the building insurance policy, the extent of building loss, the value of the building at the time of loss, the value of the machinery and equipment that was lost or damaged, and the cost of repair of repairable machinery and equipment. On May 14, 1966, the shareholders of taxpayer adopted a plan of dissolution and complete liquidation. On approximately May 20, 1966, taxpayer accepted a settlement of its building insurance claim which was paid to it on or about June 15, 1966. On approximately August 25, 1966, taxpayer accepted a settlement of its personal property insurance claim, which was paid to it on or about November 17, 1966.

On May 3, 1967, all remaining assets after liquidating distributions to shareholders were transferred to a national bank as trustee to meet claims against taxpayer and taxpayer was dissolved under Ohio law.

Taxpayer's business interruption loss claim was settled on or about August 25, 1967, and received on or about September 22, 1967.

Claiming the application of Section 337 (a) of the Internal Revenue Code of 1954, taxpayer did not report the gain realized (the difference between the basis of its

assets and the amount of insurance received) upon the involuntary conversion of its property as a result of the fire on September 10, 1965. The Commissioner determined that §337 was inapplicable because the fire occurred before adoption of the plan of liquidation and made a deficiency assessment against taxpayer for additional tax as a result of the gain realized from the involuntary conversion.

Taxpayer paid the additional tax and filed a claim for refund which was disallowed. Thereafter, an action was filed in the District Court for the Southern District of Ohio, under 28 U.S.C. §1346 (a), for recovery of the additional tax. The District Court held that the realized gain from this involuntary conversion was within the nonrecognition provisions of §337 and entered judgment for taxpayer. The Government appealed and the court of appeals reversed.

SUMMARY OF ARGUMENT

I

Section 337 is a remedial statute enacted as part of the Revenue Act of 1954 to eliminate the need for determining whether the sale of assets in the course of a corporate dissolution was made by the corporation or by the stockholders after distribution of the assets in liquidation. By removing this determination, the statute also eliminates the basis for taxing both the corporation and the stockholders for the same "sale or exchange" transaction.

The cases have uniformly held that an involuntary conversion by casualty is to be treated as a "sale or exchange" under Section 337. *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. of Cl. 1960); *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (8th Cir. 1966); cf. *Kent Manufacturing Corporation* v. *Com-*

missioner, 288 F. 2d 812 (4th Cir. 1961). And more recently it was held — *United States* v. *Morton*, 387 F. 2d 441 (8th Cir. 1968); *Kinney* v. *United States*, 73-1 USTC, ¶9140 (D. C. Cal. 1972) — that fire insurance proceeds received after adoption of a plan of dissolution from a fire occurring before adoption of the plan are entitled to nonrecognition of gain treatment under Section 337 (a).

It is submitted that *Morton* and *Kinney* were correctly decided and are dispositive of the case at bar.

II

Although an involuntary conversion by casualty may not be literally a sale or exchange, it (like an involuntary conversion by condemnation) is the same kind of transaction wherein property is converted into cash or other proceeds. The tax consequences which arise depend upon the gain or loss resulting to the taxpayer.

Conversion in a sale or exchange occurs at the point at which the right to receive cash or other proceeds becomes fixed. In a true sale this occurs when the obligation of the seller to sell and the purchaser to buy is unconditional. Treas. Reg. §1.337-2 (a). In an eminent domain proceeding the passing of title is normally held to determine the rights of the parties.[3] *West Street-Erie Boulevard Corporation* v. *United States*, 411 F. 2d 738 (2nd Cir. 1969); *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (8th Cir. 1966); *Wendell* v. *Commissioner*, 326 F. 2d 600 (2nd Cir. 1964).

By a parity of reasoning, an involuntary conversion by casualty of insured property cannot have occurred until

[3] Under laws permitting the condemnor to take immediate possession of the property, the time of possession may establish the rights of the parties for tax purposes. See *Best* v. *Humboldt Placer Mining Co.*, 371 U.S. 334 (1963); *United States* v. *Dow*, 357 U.S. 17 (1958).

some right, at least, to insurance proceeds is agreed upon or otherwise established. *United States* v. *Morton, supra*; *Kinney* v. *United States, supra*. And certainly this is not, as the decision of the court of appeals in this case would make it, at the time of the casualty in every instance.

Under the *Central Tablet* facts, the right to insurance proceeds did not accrue and the conversion did not occur until acceptance by the insurer, following adoption by taxpayer of a plan of liquidation, of the proof of loss. The decision of the court of appeals on the facts of this case is in error.

ARGUMENT

I

I. An Involuntary Conversion by Casualty is Within the Class of Transactions Congress Sought to Reach With the Enactment of Section 337.

Section 337 provides for the nonrecognition of gain or loss from the sale or exchange of property by a corporation for a period of twelve months after the adoption of a plan of complete liquidation. Its enactment followed decisions by this Court in *Commissioner* v. *Court Holding Co.*, 334 U.S. 331 (1945)[4] and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950)[5], and was intended to eliminate the formalities of sales or exchanges in corporate liquidations as the basis for taxing either the stockholders alone (*Cumberland Public Service*) or both the corporation and the stockholders

[4] Holding the gain from the sale of the single asset of a corporation by its two stockholders following transfer of the asset to them in liquidation was taxable to the corporation.

[5] Holding gains from sales by stockholders of property received in a general liquidation distribution were not taxable to the corporation.

(*Court Holding*) for substantially the same gain producing transaction.[6]

Its purpose is well stated in *Manilow* v. *United States*, 315 F. Supp. 28, 32 (N.D. Ill), as follows:

> "Congress enacted Section 337 as a remedial provision to eliminate double taxation by imposing only one tax at the shareholder level upon gains resulting from a complete corporate liquidation. The House and Senate Reports concerning this provision manifest a clear intent to eliminate the technicalities found to be of significance by the courts as the basis for taxing both the corporation and the shareholders or just the shareholders for substantially the same transaction."

Beginning with *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. of Cl. 1960)[7], it has been held in an unbroken line of cases that involuntary conversions, whether by condemnation[8] or casualty[9], are encompassed within the language "sale or exchange" as used in Section 337. The Internal Revenue Service has acquiesced in this view — Rev. Rul. 64-100.

It was more recently held in *United States* v. *Morton*,

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[6]This Congressional intent is evidenced in the statement in Hse. Rept. No. 1337, 83rd Cong. 2d Sess. 38 (3 U.S. Code Cong. & Adm. News 1954, p. 4244), that: "* * * Accordingly, under present law, the tax consequences arising from sales made in the course of liquidation depend primarily upon the formal manner in which transactions are arranged. The possibility that double taxation may occur in such cases results in causing the problem to be a trap for the unwary."

[7]In *Towanda*, the court reasoned that: "Literally, an involuntary conversion is not a sale but what Congress had in mind was a conversion of a corporation's capital assets into cash, whether voluntary or involutary, and the distribution of cash to the stockholders" (180 F. Supp. 376).

[8]*Dwight* v. *United States*, 328 F.2d 973 (2nd Cir. 1964); *Covered Wagon, Inc.*, v. *Commissioner*, 369 F.2d 629 (8th Cir. 1966).

[9]In *Kent Manufacturing Corporation* v. *Commissioner*, 288 F.2d 812 (4th Cir. 1961), it was held that a "sale or exchange" for the purposes of the operation of §392 (this section provides a special rule for liquidations occurring between June 22, 1954 and December 31, 1954) includes involuntary conversions of property by casualty.

387 F. 2d 441 (8th Cir. 1968), in further application of Section 337 to involuntary conversions, that fire insurance proceeds received after adoption of a plan of liquidation from a fire occurring before adoption of the plan constituted a nonrecognizable gain under the statute.[10]

The court of appeals below expressly declined to follow *Morton*, holding, in effect, that an involuntary conversion by casualty for the purpose of the application of Section 337 occurs in every case at the instant of the casualty. Contrary to this rule, it is the position of taxpayer that an involuntary conversion is not a single act, but, like an ordinary sale or an exchange, is a transaction which is complete when gain or loss is determined, or is reasonably determinable from the conditions of the transaction — whether they be written or arise from the surrounding circumstances.

II

II. The Court of Appeals Erred in Holding That For the Purposes of the Operation of Section 337 the Gain From an Involuntary Conversion of Property by Casualty Occurs at the Time of the Casualty.

Section 337 operates upon gain or loss from sale or exchange transactions in the course of corporate liquidations. It follows that for purposes of the statute a sale or exchange occurs at that point in time at which the events producing the gain or loss are no longer uncertain. In a

[10] The full import of *Morton* is that a "sale or exchange" by involuntary conversion is not completed until either the policy proceeds are received or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. (387 F.2d 448). In the more recent case of *Kinney v. United States*, 73-1 USTC ¶9140, decided after the decision by the court of appeals in this case, the court reached the same result reasoning that the involuntary conversion did not occur until the insurer's receipt and acceptance of the proof of loss which postdated the adoption of the plan of liquidation.

conventional sale this happens when an unconditional contract is reached by the parties.[11] In a condemnation, it is held to occur upon passage of title to the condemnor. *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (8th Cir. 1966). In an involuntary conversion by casualty it can be no sooner than the establishment of some formula for the measurement of insured losses.[12]

Relying largely on the condemnation cases, the Government's argument has been, in effect, that "sale or exchange" within the meaning of Section 337 is a title rather than a transactional concept. The further argument has been that the involuntary conversion counterpart of the passing of title in condemnations is the casualty itself which is the event that deprives the taxpayer of use and ownership of the property and converts it into a claim for compensation.

The comparison, however, is always with eminent domain proceedings in which, by local law, title passes upon the filing of the declaration of taking, or an equivalent filing.[13] And as the counterpart of this initial

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[11] Treas. Reg. §1.377-2 (a) provides: "Provided the other conditions of section 337 are met, sales or exchanges which occur on or after the date on which the plan of complete liquidation is adopted and within the 12-month period thereafter are subject to the provsions of such section. The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances. In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded. Moreover, an executory contract to sell is to be distinguished from a contract of sale. Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional."

[12] In the case at bar, the original proofs of loss were summarily rejected by the insurer (R. 25, 48). In addition there was disagreement as to the applicability of a co-insurance clause (R. 23, 33).

[13] Under what may be a majority of statutes title does not pass until an award is made or received. 26 Am. Jur. 2d, Eminent Domain §131, p. 790. See also *The Mountain Water Co. of Crescenta* v. *Commissioner*, 35 T.C. 418 (1960).

declaration or filing, the Government fastens upon the happening of the earliest event in the chain of events in an involuntary conversion by casualty transaction — the casualty — as likewise determining the time of the "sale or exchange".

But it is not the formality of the passing of title in condemnation cases that fixes this as the point at which the sale or exchange occurs for tax purposes, but the fact that at this point the obligations of the parties become unconditional. Cf. *Best* v. *Humboldt Placer Mining Co.*, 371 U.S. 334 (1963); *United States* v. *Dow*, 357 U.S. 17 (1958). And the event in an involuntary conversion which parallels the passing of title in a condemnation proceeding is the acceptance by the insurer of the proof of loss. The casualty on the other hand is more nearly like an executory contract of sale (Treas. Reg. §1.337-2 (a) footnote 11, above) — the initial act which sets in motion the conversion producing forces.

Furthermore, the conversion in a property loss by casualty is not the transformation of the property into an unproven insurance claim, but the transmutation of the property into money.[14] Under the facts of *Central Tablet*, the definitive event of this alchemy was acceptance by insurer of taxpayer's proof of loss. The reasoning of the

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[14] In *Helvering* v. *Hammel*, 311 U.S. 504, 512 (1941) in a case arising under §117 (d) of the Rev. Act of 1939, this Court, in a not dissimilar situation, held: "Respondents also advance the argument, sustained in *Commissioner* v. *Freihofer*, 102 F.2d 787, that the definitive event fixing respondents' loss was not the foreclosure sale but the decree of foreclosure which ordered the sale and preceded it. But since the foreclosure contemplated by the decree was foreclosure by sale and the foreclosed property had value which was conclusively established by the sale for the purposes of the foreclosure proceeding, the sale was the definitive event establishing the loss within the meaning and for the purpose of the revenue laws. They are designed for application to the practical affairs of men. The sale, which finally cuts off the interest of the mortgagor and is the means for determining the amount of the deficiency against him, is a means adopted by the statute for determining the amount of his capital gain nor loss from the sale of the mortgaged property."

court in *Kinney* v. *United States, supra,* is equally valid applied to *Central Tablet:*

> "* * * The same reasoning [the reasoning of the condemnation cases that upon passage of title an enforceable right to an exact award comes into being] supports the result reached in this case, an involuntary loss case, since no right to proceeds exists prior to the insurer's receipt and acceptance of the proof of loss, which postdated the adoption of the plan [of dissolution]. "(73-1 USTC, 80, 131)

Although the court in *United States* v. *Morton, supra,* came out at a different point in the sequence of events totaling the conversion, its decision supports the position of taxpayer here:

> "* * * Since no title is involved in a fire loss case of this type, we think the catastrophe is but the commencement of an involuntary conversion that does not come into fruition until, at least, the amount to be received by way of reimbursement for that loss is decided either by agreement or by court action. The payment date is significant for tax purposes in figuring gain but might not be the significant date insofar as the date of 'sale or exchange' of an involuntary converted capital asset is concerned. This would not take place until at least there was a court judgment awarding a determined fixed amount or else the parties had come to a settlement agreement on the amount of the loss, which the insurance company would be legally liable to pay in a fixed amount without any further action being necessary on the part of the taxpayer." (387 F. 2d 447)

There is no basis, legal or equitable, for holding that the casualty is in all cases the point at which an involuntary conversion occurs for the purpose of the application of Section 337 — the thrust of the court of appeals decision below. Such a holding, from a practical standpoint, excludes involuntary conversions by casualty from the

remedial operation of the statute[15] and places taxpayers back in the *Court Holding*[16] trap.

The aim of the courts ought not to be to narrowly define the reach of the statute to exclude transactions, but to extend it to all situations fairly within the statutory design. The decision below cannot be squared with the design of Section 337.

CONCLUSION

The judgment of the court of appeals in this case should be reversed.

Respectfully submitted,

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209 South High Street,
Columbus, Ohio 43215,
Attorney for Petitioner.

January 1974

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[15] The few instances in which an accidental property loss will happen after adoption of a plan of dissolution can be of little significance to the tax question involved in this case.

[16] *Commissioner* v. *Court Holding Co.*, 334 U.S. 331 (1945).

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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

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v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (Pet. App. A 11-21)[1] is reported at 339 F. Supp. 1134. The opinion of the court of appeals (Pet. App. B 22-30) is reported at 481 F. 2d 954.

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari; "A." references are to the separately bound record appendix.

JURISDICTION

The judgment of the court of appeals was entered on August 7, 1973 (Pet. App. C 31). The petition for a writ of certiorari was filed on October 3, 1973, and was granted on December 17, 1973 (A. 58). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the gain realized by a corporation from insurance proceeds arising out of the involuntary conversion of its property by fire qualifies for nonrecognition under Section 337 of the Internal Revenue Code, where the fire occurred prior to the corporation's adoption of a plan of complete liquidation.

STATUTE INVOLVED

Section 337(a) of the Internal Revenue Code of 1954 is set forth at page 2 of petitioner's brief.

STATEMENT

Petitioner was in the business of manufacturing and selling educational and art supplies. On September 10, 1965, an accidental fire largely destroyed its equipment and building, none of which was subsequently repaired or replaced. The building and equipment were covered by fire and extended coverage insurance (Pet. App. A 11-12; Pet. App. B 23; A. 32).

The insurance company did not question either the validity of the insurance contracts or the fulfillment

of the conditions for payment. It did, however, dispute the exact amount to be paid under each policy.[2] Negotiation of the claims for the building and equipment began on or about November 1, 1965.

On May 14, 1966, petitioner's shareholders adopted a plan of complete liquidation and dissolution pursuant to Section 337 of the Internal Revenue Code of 1954. Six days later, petitioner accepted a settlement of its building insurance claim of $174,595.05, which was paid on June 15, 1966. On August 25, 1966, petitioner accepted a settlement of its personal property insurance claim of $104,609.27, which was paid to it on November 17, 1966 (Pet. App. A 12-13; Pet. App. B 24; A. 33-34).

Petitioner realized a gain upon the transaction because the amount of the insurance proceeds was greater than its adjusted bases in the various items of property destroyed. However, it excluded such gain from its taxable income under Section 337(a) of the Code (A. 35). Under that provision, no gain or loss is recognized by a corporation from the sale or exchange of its property within 12 months from the adoption of a plan of complete liquidation if all of its assets are distributed in liquidation within such 12-month period.

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[2] The insurer asserted the applicability of a co-insurance clause in the building insurance policy, and questioned the extent of the building loss, the value of the building at the time of loss, the value of the machinery and equipment that was lost or damaged, and the cost of repair of repairable machinery and equipment (Pet. App. A 12; Pet. App. B 23; A. 33).

On audit, the Commissioner of Internal Revenue determined that the nonrecognition provisions of Section 337 did not apply because the conversion of the property was at the time of its destruction by fire, which occurred prior to petitioner's adoption of a plan of complete liquidation (A. 34-35). The district court upheld petitioner's claim for refund on the ground that the relevant date for purposes of Section 337 was either the date that the insurance proceeds were received or when an enforceable settlement of a determined amount was reached, both of which occurred after the adoption of the liquidation plan (Pet. App. A 13-19). The court of appeals, however, unanimously reversed, holding that the critical date for purposes of Section 337 was when the fire occurred. It refused to construe the statute to permit nonrecognition of gain when property is destroyed before adoption of a plan of liquidation (Pet. App. B 25-30).

ARGUMENT

INTRODUCTION AND SUMMARY

1. Prior to the enactment of Section 337 of the Internal Revenue Code in 1954, it was not clear under what circumstances a corporation in the process of complete liquidation would be deemed to have made a sale of its property and when its shareholders would be viewed as having made the sale. Resolution of this question was important because this common type of transaction had different tax consequences depending upon the identity of the seller of the corporate

property. If the corporation made the sale, it would be taxable on the gain, and if the amount of the liquidating distributions exceeded the shareholders' bases in their stock, another tax would be imposed upon the shareholders. See Internal Revenue Code, Section 331(a)(1). If, however, the corporate property was first distributed in liquidation and the shareholders thereafter sold it, they would be taxed upon the difference between the value of the property and the bases of their stock but no gain would be taxable to the corporation.

Although it would appear that the identity of the seller in these circumstances would be a relatively simple matter to determine, two decisions of this Court made certainty in a corporate liquidation somewhat more difficult to achieve. In *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, the Court held that the liquidating corporation made the sale even though the corporate assets were previously distributed to the shareholders and they were named as the sellers in the contract of sale. The critical fact, in the Court's view, was that the negotiations for the sale of the property were conducted by the corporation prior to the distribution of its assets to the shareholders. Conversely, in *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, the shareholders had first attempted to sell the stock of their corporation, but when the buyer refused to buy the stock, they offered to acquire the assets by liquidating the corporation and then to sell the assets. On these facts, the Court affirmed the Court of Claims' finding that

the shareholders and not the corporation had sold the assets.

After the *Court Holding* and *Cumberland Public Service Co.* decisions, it was no longer clear how shareholders might accomplish a sale of the property of their corporation so as to eliminate taxable gain to the corporation. As a result, the Senate Finance Committee at the time of the 1954 codification of the tax law observed that "[t]he result of these two decisions is that undue weight is accorded the formalities of the transaction and they, therefore, represent merely a trap for the unwary." S. Rep. No. 1622, 83rd Cong., 2d Sess., pp. 48-49. See also H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 38-39. In response to this problem, Section 337 was enacted "to provide a definitive rule which [would] eliminate the present uncertainties." S. Rep. No. 1622, *supra*, p. 258. It provides that if a corporation adopts a plan of complete liquidation and disposes of all its assets and liquidates within 12 months after the adoption of the plan, no gain or loss shall be recognized by the corporation from the sale or exchange by it of property within the 12-month period.

By its terms, the statute becomes operative only if the corporation "adopts a plan of complete liquidation" and distributes all of its assets in complete liquidation "within the 12-month period beginning on the date of the adoption of such plan." If these requirements are met, then the corporation does not recognize any gain or loss "from the sale or exchange by it of property within such 12-month period." A sale

or exchange can occur "within" the 12-month period only if it occurs subsequent to the adoption of the plan. Indeed, the only exception to this strict statutory rule is a minor one in the Regulations for sales made "before the adoption of the plan of liquidation if made on the same day such plan is adopted." Treasury Regulations, Section 1.337-1.

As a result of this rigid statutory requirement that sales occur within the 12-month period, in *Virginia Ice & Freezing Corp.* v. *Commissioner*, 30 T.C. 1251, the Tax Court, on finding that the taxpayer's sale of property was prior to the adoption of a plan of complete liquidation, held that the sale could not come within the nonrecognition provisions of Section 337 (a). See also *Whitson* v. *Rockwood*, 190 F. Supp. 478 (N. Dak.). Indeed, the paucity of cases on this point demonstrates that the statutory requirement is well understood to be absolute.

Under no circumstances, therefore, can Section 337 be construed to permit retroactive application of a plan of liquidation to cover the gain from a prior sale. Enforcement of the statutory requirement is enhanced by Section 6043(a) and Treasury Regulations, Section 1.337-6. Pursuant to those provisions, a corporation within 30 days of its adoption of a plan of liquidation must file with the Internal Revenue Service a copy of the plan, a statement of assets sold after the adoption of the plan and the dates of such sales, and information concerning the date of the final liquidating distribution. Receipt of such information by the Internal Revenue Service thereby re-

duces the likelihood that a taxpayer will claim that a plan was adopted earlier than it was in fact adopted in order to obtain nonrecognition treatment for the gain from a prior sale.[3]

2. In *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, this Court held that a sum received by a taxpayer as proceeds of insurance on buildings and equipment destroyed by fire was not a gain from the "sale or exchange" of capital assets. In the Court's analysis, the destruction of property and the payment by an insurance company for its loss was simply a single transfer to compensate the owner. Such a transaction did not contain the reciprocal transfers which are necessary to show a sale or exchange. As a result of this decision, the Internal Revenue Service initially took the position that the involuntary conversion of property by fire and the subsequent receipt of insurance proceeds was not a "sale or exchange" within the meaning of Section 337. Rev. Rul. 56-372, 1956-2 Cum. Bull. 187.

The holding in *Flaccus Leather Co.* was changed by the enactment of Section 117(j) of the Internal

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[3] The Internal Revenue Service has ruled that failure to file the information return required by Section 6043 or the information required by Treasury Regulations, Section 1.337-6, will not automatically disqualify sales from Section 337 treatment. The ruling states, however, that a failure to do so may subject the taxpayer to the provisions of Section 7203 of the Code, which impose criminal penalties for willfull failure to supply information required by the Regulations. See Rev. Rul. 65-30, 1965-1 Cum. Bull. 155. Moreover, the failure to file this information may cause the Service to question whether or when a plan was adopted.

Revenue Code of 1939 (now Section 1231 of the 1954 Code), which permitted capital gains treatment for the net gains from involuntary conversions to the same extent as if they had been realized in sales or exchanges. On the basis of this amendment of one Code provision dealing with gains from involuntary conversions, two court decisions rejected the Service's ruling position that such gains were not from sales or exchanges for purposes of Section 337. These decisions indicated, however, that nonrecognition under such circumstances was permitted only where the destruction occurred subsequent to the adoption of a plan of liquidation. See *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. Cl.); *Kent Manufacturing Corp.* v. *Commissioner*, 288 F. 2d 812 (C.A. 4).[4]

In this limited sense, therefore, the scope of the statute was extended to encompass involuntary conversions as a result of fire or other destruction. In response to these adverse decisions, the Internal Revenue Service subsequently modified its position and treated an involuntary conversion resulting from the destruction of corporate property occurring after the adoption of a plan of liquidation as if it were a "sale or exchange" for purposes of Section 337(a). See Rev. Rul. 64-100, 1964-1 Cum. Bull. (Part 1) 130.

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[4] As we discuss *infra*, pp. 15-16, *Kent Manufacturing* involved a claim under Section 392 of the Code, a transition provision with respect to sales of property by a liquidating corporation during 1954.

3. The issue in this case involves the application of the strict statutory requirement that the adoption of the plan of liquidation precede the sale or exchange. It arises in the context of the involuntary conversion of insured property as a result of its destruction by fire prior to the adoption of the plan of liquidation. Subsequent to the fire, petitioner adopted a plan of liquidation. It seeks the benefits of the nonrecognition provisions of Section 337 on the ground that the agreement as to the amount of the insurance proceeds and the payment of its claim occurred after the adoption of the plan. The court of appeals, however, correctly held that the involuntary conversion of petitioner's property occurred upon its destruction by fire and not upon the subsequent agreement or the payment of the claim. Since the fire preceded the adoption of the liquidation plan, Section 337 was held to be inapplicable.[5] In so concluding, the decision below rejected the reasoning of the Eighth Circuit in *United States* v. *Morton*, 387 F. 2d 441.

Although such an involuntary conversion is now treated as if it were a "sale or exchange" for purposes of Section 337, it is plain, as this Court held in *Helvering* v. *Flaccus eather Co.*, *supra*, that it is not identical to a sale or exchange. Nevertheless, the

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[5] There is no question that the liquidation was completed within the 12-month period. On May 3, 1967, the remaining assets, after liquidating distributions to the shareholders, were transferred to a national bank as trustee to meet claims against petitioner. On the same date, petitioner was dissolved under Ohio law (Pet. App. A 13; Pet. App. B 24; A. 34).

judicial extension of Section 337 to this type of involuntary conversion requires that analogies be drawn to other transactions where a transfer of ownership occurs.

An involuntary conversion arising out of a condemnation offers the closest analogy. With respect to such condemnations, the appellate courts, including the Eighth Circuit, have uniformly held that the involuntary "sale" for purposes of Section 337 occurs upon the initial taking of the property and not upon either the reaching of an agreement as to the amount of the condemnation award or its ultimate payment. The courts have so concluded even though a taking of property by condemnation, like the fire in this case, can occur without warning so as to prevent the timely adoption of a liquidation plan. Thus, as the decision below observed, to permit nonrecognition treatment where the destruction preceded the adoption of a plan would accord petitioner the advantage of hindsight unavailable in either an involuntary conversion by condemnation or in the usual type of sale or exchange.

There is no basis for the Eighth Circuit's decision in *Morton* that the involuntary "sale" arising out of the destruction of property occurs when the amount of the insurance proceeds is either agreed upon or paid. Unlike the moment of destruction, which can be easily ascertained, the subjective nature of the determination of when an agreement is reached would reintroduce the uncertainty in the corporate liquida-

tion process which the enactment of Section 337 was intended to eliminate.

To the extent an analogy can be drawn to the usual type of sale, both the destruction of property here and the usual type of transfer by sale operate to terminate the ownership relation with respect to property. Moreover, it is well established that a sale can occur for tax purposes long before the amount of the consideration can be ascertained. There is accordingly no justification for postponing the "sale" for purposes of the statute to the point at which the amount of insurance compensation is determined.

Finally, petitioner's position is in conflict with the undisputed rule that a taxpayer's holding period of property is coterminous with his ownership rights and that both terminate upon the destruction of the property. If, as petitioner contends, the relevant date for purposes of Section 337 was when agreement was reached regarding the amount of insurance to be paid, the questionable conclusion follows that the "sale" occurred long after the termination of petitioner's holding period and ownership. The operative event, therefore, necessarily must be the fire.

THE GAIN REALIZED BY A CORPORATION FROM INSURANCE PROCEEDS ARISING OUT OF THE INVOLUNTARY CONVERSION OF ITS PROPERTY BY FIRE DOES NOT QUALIFY FOR NONRECOGNITION UNDER SECTION 337 OF THE CODE, WHERE THE FIRE OCCURRED PRIOR TO THE CORPORATION'S ADOPTION OF A PLAN OF COMPLETE LIQUIDATION

A. The judicial extensions of Section 337 to involuntary conversions from destruction require that the plan of liquidation precede the destructive event

In enacting Section 337 to eliminate the need to identify the seller of corporate property in the course of a complete liquidation, it seems fair to conclude that Congress did not speak to the question whether gains from involuntary conversions were to be eligible for nonrecognition treatment. But Congress was surely aware of the general tax problems caused by involuntary conversions, for, as early as the Revenue Act of 1921,* the taxing statutes had provided for nonrecognition of gain from involuntary conversions where the property was replaced within a specific period of time. Because there is no reference to involuntary conversions by destruction in either the terms of Section 337 or in its legislative history which would support their inclusion into the statutory term "sale or exchange," there was certainly a

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* See Revenue Act of 1921, c. 136, 42 Stat. 227, Sections 214 (a) (12) and 234 (14), relating to individuals and corporations respectively. Although there have been changes in the statute with respect to the specific requirements for qualification, the basic nonrecognition principle survives in Section 1033 of the present Code.

persuasive case that Section 337 was not meant to apply in such circumstances. Nevertheless, the courts reasoned that Congress would not have excluded involuntary conversions arising from the destruction of insured property had it addressed the problem, and the Service announced its acceptance of these holdings.[7]

In so concluding, however, both the Court of Claims in *Towanda Textiles, Inc.* v. *United States*, *supra*, 180 F. Supp. 373, and the Fourth Circuit in *Kent Manufacturing Corp.* v. *Commissioner*, *supra*, 288 F. 2d 812, indicated that Section 337 required the adoption of the plan of liquidation to precede the destruction of the property. Thus, in *Towanda Textiles*, where the fire occurred three days after the adoption of the plan, the court stated that "It is not conceivable that Congress would have drawn a distinction between a gain from a voluntary conversion and an involuntary one, *had the possibility of an involuntary conversion during liquidation* come to its attention" (180 F. Supp. at 376) (emphasis supplied). The court's reference to a conversion "during" liquidation, coupled with the fact that the plan in that

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[7] The rationale of the decisions was grounded solely on Section 117(j) of the 1939 Code (now Section 1231 of the 1954 Code), providing that net gains from involuntary conversions of property used in trade or business shall be considered as gains from sales or exchanges of capital assets held for more than six months. While relying on this statute, the Court of Claims in *Towanda Textiles* nevertheless acknowledged that "Literally, an involuntary conversion is not a sale * * *" (180 F. Supp. at 376).

case was adopted prior to the fire, necessarily suggests its agreement with the proposition that the destruction of the property must occur after the commencement of the liquidation process, which can only be manifested by the adoption of a liquidation plan.

Similarly, the Fourth Circuit in *Kent Manufacturing Corp.* indicated that Section 337 requires that the liquidation plan precede the destruction of the property. There, both the destruction of the property and the payment of the insurance claim preceded the adoption of the liquidation plan. Although the court sustained the taxpayer's claim to nonrecognition treatment, it did so only because the transaction qualified under Section 392(b). That provision was enacted together with Section 337 in the 1954 Code to provide a transition from the 1939 Code, which contained no rule comparable to Section 337. Under Section 392(b), a liquidating corporation which made sales of its property during 1954 before the passage of Section 337 could elect nonrecognition treatment for the gain on such sales as long as it distributed all of its assets in complete liquidation before January 1, 1955. Significantly, however, the court specifically agreed with the Commissioner that Section 337 did not apply to the transaction "because the conversion did not occur and the gain was not realized *in the course of a previously planned liquidation*" (emphasis supplied) (288 F. 2d at 816).

By distinguishing between the initial "conversion" (destruction) of the property and the subsequent realization of gain (receipt of the insurance pro-

ceeds), and stating that both events must occur after the adoption of the plan, *Kent Manufacturing* correctly recognized, as the decision below held, that Section 337 applies only when the adoption of the liquidation plan precedes the destruction of the property. If, as in this case, the sequence of events had been the destruction, the adoption of the plan, and then the receipt of the insurance funds, the Fourth Circuit would not have regarded the fact that the insurance proceeds were received after the adoption of the plan as sufficient to invoke the application of the statute.

We submit that these observations by the very decisions which extended Section 337 to cover involuntary conversions by destruction correctly interpret the statutory terms to exclude the case where, as here, the destruction precedes the plan of liquidation. The holding of the Court of Claims in *Towanda Textiles* can perhaps be most easily explained on the basis of equality of treatment for all corporate gains and losses from property arising after the adoption of the plan of liquidation. If a corporation adopts a liquidation plan and thereafter its property is destroyed before it has an opportunity to dispose of it by sale or exchange, it is arguably harsh to withhold the benefits of nonrecognition.

But this rationale has no application to this case, where allowance of nonrecognition would accord preferential treatment for conversions by destruction occurring prior to the adoption of the liquidation plan over the usual type of sale or exchange which must

take place after the adoption of the plan. As the court of appeals correctly observed (Pet. App. B 30): "To expand the statute further by construing it to permit nonrecognition when the property is destroyed before adoption of a plan of liquidation would, instead of preventing injustice to a taxpayer that had decided to liquidate, give it an advantage over other taxpayers by permitting it to decide after destruction of the property whether to rebuild with insurance proceeds or to liquidate."

B. The destruction of petitioner's property by fire is analogous to the initial taking of property in an involuntary conversion by condemnation

As we have noted, the payment by an insurance company of a claim in connection with the destruction of property represents a unique category of involuntary conversion for purposes of Section 337 insofar as it does not involve any transfer of ownership. To the extent that analogies can be drawn, however, there are close parallels between this case and an involuntary conversion by condemnation where a transfer of ownership does occur. A casualty involves a sudden event, as can a condemnation (see, *e.g.*, *Dwight* v. *United States*, 328 F. 2d 973 (C.A. 2)), and both events create a claim for compensation by the owner of the property against either an insurance company or the condemning governmental authority. In both cases, the event can occur without prior warning and before the corporation is able to adopt a plan of complete liquidation.

Despite the inability of the taxpayer to act quickly under such circumstances, the courts of appeals, including the Eighth Circuit, have uniformly held that a corporation is not entitled to the benefits of Section 337 when the condemnation occurs prior to the adoption of the plan. See, *e.g.*, *Wendell* v. *Commissioner*, 326 F. 2d 600 (C.A. 2); *Dwight* v. *United States*, *supra*; *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (C.A. 8); *Likins-Foster Honolulu Corp.* v. *Commissioner*, 417 F. 2d 285, 290 (C.A. 10), certiorari denied, 397 U.S. 987. Thus, for example, in *Dwight* v. *United States*, *supra*, the Second Circuit held that the gain was realized upon the condemnation of the property and not when the award was ultimately paid. Recognizing that "the corporation had no opportunity to adopt a plan of liquidation before condemnation, and [that] the conditions of section 337 could not be met," the court observed that "[t]his may appear a harsh result, but if it is to be corrected Congress must act; the courts have no power to do so" (328 F. 2d at 974).*

Significantly, in all of the decisions involving involuntary conversions by condemnation, the operative "sale or exchange" for purposes of Section 337 was

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* In 1959, Congress was urged to provide an exception to the absolute statutory requirement by extending Section 337 to cover all types of involuntary conversions occurring prior to the adoption of a liquidation plan, but it never acted on the proposal. See Hearings before the House Ways and Means Committee, on Advisory Group Recommendations on Subchapters C, J and K of the Internal Revenue Code, 86th Cong., 1st Sess., pp. 473, 532.

uniformly held to have occurred when the incidents of ownership of the property passed from the taxpayer to the condemning authority. Contrary to the statement of the district court in *Kinney* v. *United States*, 73-1 U.S.T.C. ¶ 9140 (decided November 10, 1972 (N.D. Cal.), on appeal to the Court of Appeals for the Ninth Circuit), upon which petitioner relies (Br. 11), the condemnation decisions so held even though the amounts of compensation the taxpayers were to receive had not yet been determined.[9] Thus, just as the "sale or exchange" in the condemnation cases arose upon the taking of the property and did not depend upon the ultimate agreement as to the award or its payment, so did the judicially-created "sale or exchange" of petitioner's property occur upon its destruction and not when the amount of the

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[9] Condemnation statutes differ. While some require that the amount of compensation be fixed before the condemning authority has the right to take the property, others provide that the filing of a notice of taking transfers ownership to the condemning authority. For purposes of Section 337, however, the consistent rule is that the conversion occurs when the taxpayer is required by local law to part with the incidents of ownership in the property and receive in substitution a right to compensation, regardless of whether or not the precise amount of compensation has been determined at that time. See Rev. Rul. 59-108, 1959-1 Cum. Bull. 72.

Cf. *Mountain Water Co. of La Crescenta* v. *Commissioner*, 35 T.C. 418, acquiescence, 1961-1 Cum. Bull. 4. There, the transfer of the property to the condemning authority did not occur under the local procedure until the taxpayer agreed to accept the amount of a court-determined award. The Tax Court found as a fact that at that point in time a plan of liquidation had been adopted.

insurance claim was subsequently agreed upon or paid.

For purposes of Section 337, there is no difference between a corporation which has parted with the incidents of ownership of its property as a result of a taking by condemnation and one which has suffered the destruction of property covered by insurance. In both cases, the corporation's prior relationship to the property has been irrevocably terminated and transformed into a claim for compensation. Unless such a transformation occurs subsequent to the adoption of the liquidation plan, the nonrecognition provisions of Section 337 are inapplicable.

C. The involuntary conversion as a result of a fire loss is not postponed beyond the time of the fire even though no transfer of ownership is involved.

In contending that the date of the involuntary conversion of its destroyed property was subsequent to the adoption of a liquidation plan, petitioner relies principally (Br. 8-12) upon the decision of the Eighth Circuit in *United States* v. *Morton*, 387 F. 2d 441, and of the district court in *Kinney* v. *United States*, 73-1 U.S.T.C. ¶ 9140 (decided November 10, 1972 (N.D. Cal.), on appeal to the Court of Appeals for the Ninth Circuit). Petitioner however, appears unable to settle upon any one particular event in the sequence from destruction to ultimate payment of the claim. Thus, for example, it first contends (Br. 9) that the conversion occurs when a formula is established for the measurement of the insured loss. It next urges (Br. 10) that the conversion arises

when the insurer accepts the proof of loss. Finally, it proposes yet another theory (Br. 10), that the relevant event is the payment of the insurance claim.

Such uncertainty on the part of petitioner is hardly surprising in view of the divergence of approach between the *Morton* and *Kinney* decisions themselves. In *Morton*, the court held that "[s]ince no title is involved in a fire loss case of this type, we think the catastrophe is but the commencement of an involuntary conversion that does not come into fruition until, at least, the amount to be received by way of reimbursement for that loss is decided either by agreement or by court action" (387 F. 2d at 447). In marked contrast, however, the district court in *Kinney* concluded that "under the insurance policy until the proof of loss had been submitted and accepted by the insuror, there was no legally enforceable right to the proceeds accruing to the taxpayer" (73-1 U.S.T.C. at 80,131).[10]

The applicability of Section 337, a provision designed to bring objective certainty into the corporate liquidation process, should not turn upon the subjective inquiry required by *Morton* as to when an agree-

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[10] Unlike *Morton* where the agreement respecting the amount of insurance payable was reached after the adoption of the plan, such an agreement was reached in *Kinney* prior to the plan of liquidation (73-1 U.S.T.C. at 80,128). Thus, the court in *Kinney* could not have held for the taxpayer had it strictly followed the *Morton* rationale. It viewed the filing of the proof of loss with the insurer, which occurred subsequently to the adoption of the plan, as the pertinent event under Section 337.

ment respecting compensation is reached between the taxpayer and the insurer. Unlike the time of the casualty, which is, for the most part, easily and objectively ascertained, there is great potential for disagreement among triers of fact in applying the *Morton* standard.[11] Indeed, Section 337 was enacted to eliminate the confusion caused by disagreement among finders of fact. Compare *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, 454, n. 3, with *Commissioner* v. *Court Holding Co.*, 324 U.S. 331. The *Morton* standard would reintroduce the same type of uncertainty which existed prior to 1954 with respect to conversions arising from casualties.[12]

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[11] The inquiry required by the district court in *Kinney* as to when the proof of loss is "submitted and accepted" is similarly subjective in nature.

[12] Since Section 337 precludes the recognition of losses after the adoption of a liquidation plan, the uncertainty of when an "agreement" is reached under the *Morton* rationale could well work a hardship upon taxpayers. For example, suppose a corporation suffers a loss of a major asset with a basis of $100,000. Although it is uncertain as to the amount the insurer will pay, it submits a claim for $200,000. After considerable discussion, however, the insurance company "agrees" to pay $25,000 in compensation. If the corporation thereafter decides to liquidate and wishes to obtain Section 337 treatment with respect to other assets it can sell at a gain, it is unclear at what point it should adopt the plan of liquidation. It cannot adopt the plan before it ascertains whether the insurance proceeds will produce gain or a loss. To do so will preclude recognition of the possible loss. Similarly, it cannot wait to adopt the plan until after the amount of insurance is ascertained without risking the possibility of having to recognize a possible gain if the insurer pays the entire claim. By fixing the casualty as the "sale" for Section 337 purposes, the decision

Moreover, the *Morton* rule would create a difference in treatment between involuntary conversions by condemnation and those arising by casualty. In the Eighth Circuit's view, such a difference is justified because a condemnation involves a transfer of ownership while a casualty does not. But this, we submit, is a distinction without a difference for purposes of Section 337.

The fact that the statutory term "sale or exchange" has been extended by the courts to encompass involuntary conversions resulting from destruction of property requires the selection of the single event which most closely corresponds to the point at which a sale or exchange occurs, *viz.*, when the benefits and burdens of ownership are transferred so as to terminate the seller's relationship to the property. See *e.g.*, *Lucas* v. *North Texas Co.*, 281 U.S. 11; *Boykin* v. *Commissioner*, 344 F. 2d 889 (C.A. 5); *Wiseman* v. *Scruggs*, 281 F. 2d 900 (C.A. 10); *Commissioner* v. *Baertschi*, 412 F. 2d 494 (C.A. 6). The destruction by fire of petitioner's property terminated the relationship it maintained with respect to the property just as if it had transferred the incidents of ownership by sale or condemnation. In all cases, continued use by the owner is no longer possible.

Petitioner, however, argues (Br. 10) that the agreement as to the amount of the insurance proceeds is the point at which the "sale" occurs because the usu-

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below provides a uniform rule of certainty which allows the recognition of losses under such circumstances and requires the recognition of gains.

al type of sale does not arise until the price is determined. This analogy is unsound because it confuses the concept of a sale with the realization of gain or loss from a sale.

There are many situations where the amount of the sales price is subject to future contingencies so that the precise amount of gain or loss cannot be ascertained at the time of transfer of ownership. Despite this fact, a sale has nevertheless occurred for tax purposes. See, *e.g.*, *Burnet* v. *Logan*, 283 U.S. 404; *Gralapp* v. *United States*, 458 F. 2d 1158 (C.A. 10); *United States* v. *Jones*, 194 F. 2d 783 (C.A. 10); *Estate of Marshall* v. *Commissioner*, 20 T.C. 979; and *Cluff* v. *Commissioner*, 17 T.C. 225.[13] Thus, the computation of the sales price after the contingencies have occurred is wholly separate and apart from the sale itself.

Similarly, here, the occurrence of the fire created an unconditional obligation by the insurer to pay compensation in accordance with the contract of insurance. The subsequent agreement as to the amount of the compensation is simply an application of the policy provisions to the specific facts of the case. In

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[13] By way of further illustration, it is quite common for one corporation to acquire the stock of another corporation in exchange for a fixed number of shares of the acquiring corporation's stock plus a contingent number of shares based upon either the future market price of the shares or upon the future earnings of the acquired corporation. The Service has ruled that such transactions are exchanges which are nontaxable under Section 368(a)(1)(B). See Rev. Rul. 66-112, 1966-1 Cum. Bull. 68; Rev. Rul. 67-90, 1967-1 Cum. Bull. 79.

that sense, it is analogous to the computation of a sales price under a contigency formula.[14]

Finally, petitioner's position and that of the Eighth Circuit in *Morton* is inconsistent with the rules governing the holding period of property for purposes of measuring whether the gain from the sale of a capital asset is taxable as short-term or long-term capital gain. See Section 1222 of the Code. In *McFeely* v. *Commissioner*, 296 U.S. 102, 107, this Court ruled that a taxpayer's holding period with respect to property was coterminous with the period of his ownership.[15] It was subsequently held with respect to a condemnation that the taxpayer's holding period ends with the transfer of ownership to the condemning authority. *Commissioner* v. *Kieselbach*, 127 F. 2d 359, 363 (C.A. 3), affirmed on another issue, 317 U.S. 399.

Similarly, in the case of a conversion by destruction, the taxpayer's holding period ends with the destruction. *Steele* v. *United States*, 52-2 U.S.T.C. ¶ 9451, decided March 25, 1952 (S.D. Fla.); *Rose* v. *United States*, 229 F. Supp. 298, 300 (S.D. Cal.). In those cases, involving sunken ships, the courts rejected the taxpayers' attempts, similar to that of

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[14] Petitioner further contends (Br. 10) that the fire is comparable to an executory contract of sale which is executed only when the amount of insurance is payable. But in an executory contract, the position of the parties may be restored to *status quo ante*. This is not possible, however, where the property has been destroyed.

[15] See also *Hooper* v. *Commissioner*, 26 B.T.A. 758, and I.T. 3287, 1939-1 Cum. Bull. (Part 1) 138.

petitioner, to postpone the dispositive event beyond the casualty to the time when they abandoned the property and were compensated by the insurer. In light of these holdings, the correctness of which are not in dispute,[16] petitioner's position is reduced to the questionable proposition that the "sale" of its property for purposes of Section 337 took place long after its ownership and holding period had ended. The "sale," therefore, must be deemed to have occurred at the time petitioner's property was destroyed by fire.

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[16] The Eighth Circuit in *Morton* acknowledged that these cases are "sound as it would be difficult to hold a capital asset after its destruction * * *." It noted, however, that they "appear to be of limited relevance in determining when a sale or exchange has taken place in the event of an involuntary conversion of a capital asset through destruction" (387 F.2d at 446).

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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MARCH 1974.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

CENTRAL TABLET MANUFACTURING CO., *Petitioner*,

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

1. There Is No Previous Case Or Logical Basis For Concluding That The Plan Of Liquidation Must Precede The Casualty In The Application Of Section 337 To Involuntary Conversions.

While conceding, grudgingly, that an involuntary conversion by casualty is to be treated as a "sale or exchange" under Section 337 (a), respondent urges adoption of the rule that the casualty is in all instances the point of the conversion. A rule which would cause a quite different application of the statute to involuntary conversions than to true sales and exchanges.

Respondent argues, in support of this rule, that this is the implication of *Towanda Textiles, Inc.* v. *United*

States, 180 F.Supp. 373 (Ct. of Cl. 1960) and *Kent Manufacturing Corporation v. Commissioner*, 288 F.2d 812 (4th Cir. 1961), as evidenced by the language in *Towanda* which refers to the involuntary conversion (caused in that case by a fire which occurred after adoption of a plan) as happening during liquidation and the language in *Kent* which distinguishes between the conversion and the realization of gain.[1] The language referred to, however, is equally consistent with the conclusion that involuntary conversion—as distinguished from the casualty—occurs at the point, following the casualty, that the right to receive insurance proceeds becomes unconditional or enforceable. In actuality, these cases do not bear on the narrow question raised here and the two cases that do—*United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968) and *Kinney* v. *United States*, 73-1 USTC, ¶9140 (D. C. Cal. 1972) are directly contrary to respondent's position.

While an involuntary conversion by casualty of insured property may not be literally a sale or exchange, it has the characteristics of both transactions. Like a sale, there is frequently a transfer of ownership, which is reflected by an adjustment for salvage, and like an exchange there is an exchange of one kind of property for another—insurance proceeds. Contrary to respondent's proposal, an involuntary conversion by casualty is not a single destructive event, but a transaction which occurs for the purpose of the application of Section 337 (a), when the right to receive insurance proceeds is no longer contingent.[2]

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1. As it does throughout, respondent assumes, circularly, that the involuntary conversion is the destruction (casualty) and that these cases, therefore, imply that the destruction must occur after adoption of the plan.
2. This characterization of an involuntary conversion was referred to in *Helvering v. Flaccus Leather Co.*, 313 U.S. 247, 249 (1941) as follows: "The fact that §112 (f) characterizes destruction of property and indemnification for its loss as in involuntary conversion does not establish that the two events constituted a sale or exchange".

2. The Analogy Between The Destruction Of Petitioner's Property By Fire And The Taking Under An Eminent Domain Proceeding Is False.

From the outset of this case, respondent has avoided comparison of the fire loss with a sale and has sought instead to relate it to a taking under eminent domain statutes. There is a significant difference, however, between the taking in eminent domain and the fire in this case.

In a condemnation, the taking marks the entry of the condemnor into possession and gives rise to an enforceable obligation to pay just compensation. *Best* v. *Humboldt Placer Mining Co.*, 371 U.S. 334, 340 (1963); *United States* v. *Dow*, 357 U.S. 17, 22 (1958). Indeed, it is only because of the creation of this enforceable obligation that the taking is constitutional. See *Yearsley* v. *W. A. Ross Construction Co.*, 309 U.S. 18 (1940). The casualty in an involuntary conversion on the otherhand gives rise, at most, to a conditional or contingent claim. The insurer is under no obligation unless and until a number of actions are taken by the insured—notice of loss, proof of loss in accordance with the terms of the policy and other requirements for recovery under the policy.

The contingent nature of an insurance claim can be no more clearly shown then by the facts of this case. Thus, the insurers rejected petitioner's proofs of loss (R. 13-15, 48); took the position that their liability under the building loss policy was limited by the operation of a co-insurance clause (R. 23, 33); and disagreed with petitioner as to the machinery and equipment that was repairable and, in some cases, as to its coverage under the policy (R. 27, 28). All of these contingencies to the receipt of insurance proceeds remained until acceptance by insurers of petitioner's proofs of loss, which postdated adoption of its plan of liquidation. And it was this event,

not the fire, which transmuted petitioner's property rights in the damaged property into an enforceable right to insurance proceeds—the involuntary conversion.

The further argument that to permit nonrecognition treatment where the casualty precedes the adoption of a plan of liquidation is to favor taxpayers in petitioner's position by allowing them to decide whether to rebuild or to liquidate[3] is not persuasive. Under existing Treasury Regulations[4], sales may be negotiated before a plan of liquidation is adopted and still be entitled to nonrecognition and, under probably the greater number of statutes, the landowner knows well before the taking that eminent domain proceedings will be brought. In truth, in this regard, a reversal of the judgment of the court of appeals in this case will have the effect of placing petitioners and similarly situated taxpayers on an equal footing with taxpayers involved in true sales and exchanges.

Nor is there merit to the ominous prediction that any rule other than that an involuntary conversion occurs at the time of the casualty will reintroduce the uncertainty to the corporate liquidation process that §337 was designed to eliminate. Certainly, the provision in Treasury Regulation, §1.337-2 (a) that "[t]he date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances" gives rise to this same kind of factual determination. And just as

3. This fear appears largely to have been the basis for the judgment of the court of appeals below (Petition For Writ Of Certiorari, p. 30).

4. §1.337-2 (a) provides "***[i]n ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded".

certainly, this kind of determination must be made time and again in the administration of tax laws and laws generally.

The fact that the time of the occurrence of a casualty is easily ascertainable is no basis in law for arbitrarily fixing it as the time of the involuntary conversion.

3. The Time Of The Involuntary Conversion Is Not Extended Beyond The Holding Period And Ownership Of The Converted Property Under Petitioner's Theory.

Respondent's argument here is that this Court in *McFeely v. Commissioner*, 296 U.S. 102 (1935), held that taxpayer's holding period with respect to property is coterminous with the period of his ownership and that it has been subsequently held—*Rose* v. *United States*, 229 F. Supp. 298 (S. D. Cal. 1964); *Steele* v. *United States*, 52-2 USTC ¶9451 (S. D. Fla. 1951)—that a taxpayer's ownership ends at the time of the casualty in an involuntary conversion.

Accepting the principle stated in *McFeely* v. *Commissioner*, it still does not follow from *Rose* and *Steele* that petitioner's ownership of its fire damaged property ended with the fire.

In *Steele*, the vessel—the insurance proceeds from which were claimed by taxpayer to reflect long term gain—sank without a trace[5] and presumably ownership and possession were abandoned. In *Rose*, the casualty was also the sinking of a vessel and, although the location of the hulk was known, no effort was made by either the taxpayer or the insurer to investigate the loss or to attempt salvage operations. While an arbitrary termination date for ownership corresponding to the date of

5. The decision gives no further facts or supportive reasoning.

casualty was fixed by both courts, the date seems justified under the peculiar facts of those cases. But clearly, those determinations are not dispositive of the question of ownership under the differing circumstances of this case.

In *Central Tablet*, both the building and the personal property remained in existence—although damaged and rendered largely useless by the fire—and petitioner's ownership continued until the damaged property was, in effect, exchanged for insurance proceeds. A transaction which took place no sooner than the acceptance of proofs of loss by insurers.

To say, as respondent must to sustain its position, that in every involuntary conversion by casualty case, title to and ownership of the property terminates at the time of the casualty is to ignore the facts of this case and the circumstances of most casualty losses. Contrary to respondent's argument, petitioner's position in this case and the decisions in *United States* v. *Morton, supra*, and *Kinney* v. *United States, supra*, are consistent in principle with this Court's decision in *McFeely* v. *Commissioner*, and can be squared on the facts with the holdings in *Steele* and *Rose*.

In summary, an involuntary conversion by casualty, like a true sale or exchange, is a transaction which occurs for the purpose of the application of Section 337 (a) at the point that an enforceable obligation to receive money or tangible property arises. Under the facts of this case, this definitive event occurred at the time of the acceptance of proofs of loss by the insurers, following the adoption by petitioner of its plan of liquidation. It follows that petitioner is entitled to the application of the remedial nonrecognition provisions of Section 337

(a) and that the judgment of the court of appeals denying such application is in error.

Respectfully submitted,

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(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

CENTRAL TABLET MANUFACTURING CO. *v.* UNITED STATES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 73-593. Argued March 25-26, 1974—Decided June 19, 1974

When a fire destroys insured corporate property *prior* to the corporation's adoption of a complete plan of liquidation, but the fire insurance proceeds are received within 12 months after the plan's adoption, the gain realized from the excess of such proceeds over the corporate taxpayer's adjusted income tax basis in the insured property must be recognized and taxed to the corporation, and is not entitled to nonrecognition under § 337 (a) of the Internal Revenue Code of 1954, which provides, with certain exceptions, for nonrecognition of gain or loss from a corporation's "sale or exchange" of property that takes place during the 12-month period following the corporation's adoption of a plan for complete liquidation effectuated within that period. Pp. 4-18.

(a) The involuntary conversion by fire, recognized as a "sale or exchange" under § 337 (a), takes place when the fire occurs prior to the adoption of the liquidation plan, and not at some post-plan point, such as the subsequent settlement of the insurance claims or their payment, since the fire is the single irrevocable event that fixes the contractual obligation precipitating the transformation of the property, over which the corporation possesses all incidents of ownership, into a chose in action against the insurer. Pp. 10-12.

(b) Section 337 (a) was enacted in order to eliminate technical and formalistic determinations as to the identity of the vendor, as between the liquidating corporation and its shareholders, and, therefore, the reasons for applying § 337 (a) are not present in a situation where the conversion takes place prior to the adoption of the plan when there is no question as to the identity of the owner. Pp. 13-14.

481 F. 2d 954, affirmed.

Syllabus

BLACKMUN, J., delivered the opinion of the Court, in which BURGER, C. J., and STEWART, MARSHALL, and REHNQUIST, JJ., joined. WHITE, J., filed a dissenting opinion, in which DOUGLAS, BRENNAN, and POWELL, JJ., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 73-593

Central Tablet Manufacturing Co., Petitioner, *v.* United States. | On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

[June 19, 1974]

MR. JUSTICE BLACKMUN delivered the opinion of the Court.

Section 337 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 337 (a),[1] provides, with stated exceptions, for the nonrecognition of gain or loss from a corporation's "sale or exchange" of property that takes place during the 12-month period following the corporation's adoption of a plan of complete liquidation that is effectuated within that period. The issue in this case is whether, when a fire destroys corporate property *prior* to the adoption of a plan of complete liquidation, but the fire insurance proceeds are received after the plan's adoption,

[1] "§ 337. Gain or loss on sales or exchanges in connection with certain liquidations.

"(a) General rule.

"If—

"(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

"(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

"then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period." 26 U. S. C. § 337 (a).

the gain realized is or is not to be recognized to the corporation.

I

The facts are not contested. Taxpayer, Central Tablet Manufacturing Company, an Ohio corporation, for many years prior to May 14, 1966, was engaged at Columbus, Ohio, in the manufacture and sale of writing tablets, school supplies, art materials, and related items. It filed its federal income tax returns on the accrual basis of accounting and for the fiscal year ended October 31.

On August 13, 1965, a majority of the taxpayer's production and maintenance employees went on strike. As a consequence, production was reduced to about 5% of normal volume. On September 10, during the strike, an accidental fire largely destroyed the taxpayer's plant, its manufacturing equipment and machinery, and its business offices. The damage was never repaired, the strike was never settled, and the taxpayer never again engaged in manufacturing.

At the time of the fire, the taxpayer carried fire and extended coverage insurance on its building, machinery, and inventory. It also carried business interruption insurance. Negotiations relating to the taxpayer's claim for business interruption loss began about October 8, 1965, and those on its claims for building and personal property losses began about November 1. There was dispute as to the estimated period of loss to be covered by the business interruption insurance; as to the probable duration of the strike had the fire not taken place; as to the applicability of the building policy's coinsurance clause; as to the extent of the equipment loss due to the fire rather than to rain; as to the value of the building and equipment at the time of the fire; and as to the cost of repair of repairable machinery and equipment. The threshold liability of the insurance carriers,

however, despite their not unusual rejection of the initial formal proofs of claim, was never seriously questioned.

Eight months after the fire, at a special meeting on May 14, 1966, the shareholders of Central Tablet decided to dissolve the corporation and adopted a plan of dissolution and complete liquidation pursuant to Ohio Rev. Code § 1701.86 (Repl. 1964). App. 38. About six days later, the taxpayer and the insurers settled the building claim; payment of that claim was received in mid-June. In August, the taxpayer settled its personal property claim and received payment on it in November. On May 3, 1967, all assets remaining after liquidating distributions to the shareholders were conveyed to a Columbus bank in trust for the shareholders pending the payment of taxes and the collection of remaining insurance and other claims. On the same date, the taxpayer filed a certificate of dissolution with the Ohio Secretary of State. Ohio Rev. Code §§ 1701.86 (H) and (I) (Repl. 1964). All this was accomplished within 12 months of the adoption of the plan on May 14, 1966.

The business interruption claim was settled in August 1967 and payment thereof was received in September of that year.

The fire insurance proceeds exceeded the taxpayer's adjusted income tax basis in the insured property. Gain, therefore, was realized and ordinarily would be recognized and taxed to the corporation. § 1033 (a)(3) of the 1954 Code, 26 U. S. C. § 1033 (a)(3); *Max N. Tobias*, 40 T. C. 84, 95 (1963). The taxpayer, however, resorting to § 337 (a), did not report this gain or any part of the business interruption insurance payment in its income tax returns for fiscal 1965 or for any year. In January 1968, upon audit, the Internal Revenue Service asserted a deficiency in the taxpayer's income tax for fiscal 1965. This was attributable to the Service's inclusion in gross income for that year of (a) capital gain

equal to the excess of the fire insurance proceeds over adjusted basis, (b) fiscal 1965's pro rata share of the business interruption insurance payment, and (c) an amount not at issue here. A deficiency in the taxpayer's fiscal 1963 tax was also asserted; this was attributable to a decrease in operating loss carryback from fiscal 1966 because of adjustments in the treatment of the insurance proceeds.[2] The taxpayer paid the deficiencies, filed claims for refund, and, in due time, instituted the present action in federal court to recover the amounts so paid.

The District Court followed the decision in *United States* v. *Morton*, 387 F. 2d 441 (CA8 1968), which concerned a taxpayer on the cash, rather than the accrual, basis, and held that § 337 (a) was available to the taxpayer. 339 F. Supp. 1134 (SD Ohio 1972).[3] Judgment for the taxpayer was entered. On appeal, the United States Court of Appeals for the Sixth Circuit, refusing to follow *Morton*, reversed and remanded. 481 F. 2d 954 (1973). In view of the indicated conflict in the decisions of the Eighth and Sixth Circuits, we granted certiorari. 414 U. S. 1111 (1973).

II

The only issue before us is whether § 337 (a) has application in a situation where, as here, the involuntary conversion occasioned by the fire preceded the adoption of the plan of complete liquidation.[4] This depends upon

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[2] The deficiencies, including interest, amounted to $70,051.30 for fiscal 1965 and $11,930.30 for fiscal 1963.

[3] *Kinney* v. *United States*, 73–1 T. C. ¶ 9140 (ND Cal. 1972), decided before the Sixth Circuit's ruling in the present case, and now on appeal to the Ninth Circuit, also followed *Morton*. The corporate taxpayer in *Kinney* was on the accrual basis.

[4] Because the District Court ruled that § 337 (a) had application to Central Tablet's situation, there was no occasion for it to determine in what taxable year the gain to the corporation accrued if it were ultimately decided that § 337 (a) was not applicable. That question remains for resolution upon remand. We intimate

whether the "sale or exchange," referred to in § 337 (a), took place when the fire occurred or only at some post-plan point, such as the subsequent settlement of the insurance claims, or their payment.

Stated simply, it is the position of the Government that the fire was a single destructive event that effected the conversion (and, therefore, the "sale or exchange") prior to the adoption of the plan of liquidation, thereby rendering § 337 (a) inapplicable. It is the position of the taxpayer, on the other hand, that the fire was not such a single destructive event at all, but was only the initial incident in a series of events—the fire; the preparation and filing of proofs of claim; their preliminary rejection; the negotiations; ultimate dollar agreement by way of settlement; the preparation and submission of final proofs of claim; their formal acceptance; and payment—that stretched over a period of time and came to a meaningful conclusion only *after* the adoption of the plan, and that, consequently, § 337 (a) is applicable.

In order to keep this narrow issue in perspective, it is desirable and necessary to examine the background and the history of § 337.

A corporation is a taxable entity separate and distinct from its shareholders. Ordinarily, a capital gain realized by the corporation is taxable to it. The shareholders, of course, benefit by that realization of gain and the consequent increase in their corporation's assets. The value of their shares, in theory, is thereby enhanced. This increment in value, however, is not taxed at that point to the shareholder. His taxable transaction occurs when he disposes of his shares. The capital gain realized by the corporation, and taxed to it, may be said to be subject to a "second" tax later, that is, when the shareholder dis-

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no view as to that issue. See, generally, 2 J. Mertens, Law of Federal Income Taxation § 12.65 and p. 236 (1967 Rev.).

poses of his shares. There is nothing unusual about this. It is a reality of tax law, and it is due to the separateness of the corporation and the shareholder as taxable entities.

This "double tax" possibility took on technical aspects, however, when the capital gain was realized at about the time of, or in connection with, a corporation's liquidation. If liquidation was deemed to have taken place subsequent to the sale or exchange, there was a "second" tax to the shareholder in addition to the tax on the gain to the corporation. On the other hand, because a corporation itself realizes no gain for income tax purposes upon the mere liquidation and distribution of its assets to shareholders, § 311 of the 1954 Code, 26 U. S. C. § 311; see *General Utilities Co.* v. *Helvering,* 296 U. S. 200 (1935), if the liquidation was deemed to have preceded the sale or exchange of the asset, there was no "first" tax to the corporation. Thus, the timing of the gain transaction, in relation to the corporation's liquidation, had important tax consequences. See, generally, B. Bittker and J. Eustice, *Federal Income Taxation of Corporations and Shareholders* 11–53 (3d ed. 1971). In short, before § 337 came into the Internal Revenue Code, the overall income tax burden for the liquidating corporate taxpayer and its shareholders was less if the corporation clearly made its distribution of assets prior to the sale or exchange of any of them at a gain.

All this seemed simple and straightforward. The application of the rule, however, as fact situations varied, engendered profound confusion which was enhanced by two decisions by this Court approximately 25 years ago. In *Commissioner* v. *Court Holding Co.,* 324 U. S. 331 (1945), the Court held that a liquidating corporation could not escape taxation on the gain realized from the sale of its sole asset if the corporation itself had arranged the sale prior to liquidation and distribution of the asset to the shareholders. This was so even though the sale

was consummated after the distribution. Subsequently, in *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451 (1950), the Court reached exactly the opposite conclusion in a case where the shareholders, rather than the corporation, had negotiated the sale of the distributed assets and, prior to the corporation's liquidation, had been in touch with the purchaser and had offered to acquire the property and sell it to the purchaser. Mr. Justice Black, who wrote for a unanimous court in both cases, recognized that "the distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held," *id.*, at 454–455, but the Court, nonetheless, determined that the distinction was mandated by the Code:

> "The oddities in tax consequences that emerge from the tax provisions here controlling appear to be inherent in the present tax pattern. For a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet it is not taxed if that property is distributed in kind and is then sold by the shareholders. In both instances the interest of the shareholders in the business has been transferred to the purchaser. . . . Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate." *Id.*, at 455–456.

These two cases obviously created a situation where the tax consequences were dependent upon the resolution of often indistinct facts as to whether the negotiations leading to the sale had been conducted by the corporation or by the shareholders. Particularly in the case of a closely held corporation, where there was

little, if any, significant difference between management and ownership, this analytical formalism was unsatisfactory and, indeed, was a trap for the unwary. S. Rep. No. 1622, 83d Cong., 2d Sess., 49 (1954); H. Rep. No. 1337, 83d Cong., 2d Sess., A106 (1954). See Cary, The Effect of Taxation on Selling Out a Corporate Business for Cash. 45 Ill. L. Rev. 423 (1950).

It was in direct response to the *Court Holding-Cumberland* confusion and disparate treatment that Congress produced § 337 of the Internal Revenue Code of 1954. The Report of the House Committee on Ways and Means on the bill (H. R. 8300) which became the 1954 Code explained the purpose of § 337:

> "Your committee's bill eliminates questions arising as a result of the necessity of determining whether a corporation in process of liquidating made a sale of assets or whether the shareholder receiving the assets made the sale. Compare *Commissioner* v. *Court Holding Company* (324 U. S. 331), with *U. S.* v. *Cumberland Public Service Company* (338 U. S. 451). This last decision indicates that if the distributee actually makes the sale after receipt of the property then there will be no tax on the sale at the corporate level. In order to eliminate questions resulting only from formalities, your committee has provided that if a corporation in process of liquidation sells assets there will be no tax at the corporate level, but any gain realized will be taxed to the distributee-shareholder, as ordinary income or capital gain depending on the character of the asset sold." H. R. Rep. No. 1337, 83d Cong., 2d Sess., 38–39 (1954).

See also *id.*, at A106–A109, where it was said, at A106, "Your committee intends in section [337] to provide a definitive rule which would eliminate any uncertainty."

See S. Rep. No. 1622, 83d Cong., 2d Sess., 48–49, 258–260 (1954).

There is nothing in the legislative history indicating that § 337 was enacted in order to eliminate "double taxation" as such. Rather, the statute was designed to eliminate the formalistic distinctions recognized and perhaps encouraged by the decisions in *Court Holding* and *Cumberland*. See Kovey, When Will Section 337 Shield Fire Loss Proceeds? A Current Look at a Burning Issue, 39 J. Tax. 258, 259 n. 2 (1973); Note, Tax-Free Sales in Liquidation Under Section 337, 76 Harv. L. Rev. 780 (1963). See also *West Street-Erie Boulevard Corp.* v. *United States*, 411 F. 2d 738, 740–741 (CA2 1969). The statute was meant to establish a strict but clear rule, with a specified time limitation, upon which planners might rely and which would serve to bring certainty and stability into the corporation liquidation area. The taxpayer here recognizes this statutory purpose. Brief for Petitioner 6–7; Tr. of Oral Arg. 3–4.

Inasmuch as § 337 was drafted to meet and deal with the *Court Holding-Cumberland* situation, where there had been a sale, the statute on its face relates only to "the sale or exchange" of property. It is not surprising, therefore, that further confusion resulted when the Internal Revenue Service found itself confronted by liquidating corporate taxpayers who sought § 337 (a) treatment for casualty gains. Following the Court's decision in *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247 (1941),[5] the Internal Revenue Service at first refused to consider § 337 as applicable to a casualty situ-

[5] In *Flaccus* the Court held that fire insurance proceeds did not result in gain from a "sale or exchange" of capital assets within the meaning of § 117 (d) of the Revenue Act of 1934. This result was overcome statutorily by the enactment of § 151 (b) of the Revenue Act of 1942, 56 Stat. 846, now carried over into § 1231 (a) of the 1954 Code, 26 U. S. C. § 1231 (a).

ation at all. Rev. Rul. 56–372, 1956–2 C. B. 187. When this was rejected in the courts,[6] the Service reversed its position and treated an involuntary conversion that occurred after adoption of a plan of complete liquidation as a "sale or exchange" with resulting nonrecognition. Rev. Rul. 64–100, 1964–1 C. B. (Part I) 130.

It is at this point that the issue of the instant case emerges and comes into focus. Although it is now settled that an involuntary conversion by fire is a sale or exchange under § 337 (a), the question that is determinative here remains unresolved: When does the involuntary conversion by a preplan fire take place? Since the statute prescribes a strict 12-month postplan period, it is crucial for the taxpayer that the conversion be deemed to have occurred after the plan of liquidation was adopted.

III

Predictably, the taxpayer analogizes the involuntary conversion to a true sale, and it argues that the conver-

[6] *Towanda Textiles, Inc.* v. *United States*, 149 Ct. Cl. 123, 180 F. Supp. 373 (1960); *Kent Mfg. Corp.* v. *Commissioner*, 288 F. 2d 812 (CA4 1961). In each of these cases the Court relied upon the *Flaccus*-inspired statutory amendment, referred to in the preceding footnote, for its conclusion that an involuntary conversion was covered by § 337 (a). In *Towanda* the Court of Claims permitted § 337 (a) treatment where both the fire and the settlement occurred during the 12-month period *following* the adoption of the plan of liquidation. It observed, "It is not conceivable that Congress would have drawn a distinction between a gain from a voluntary conversion and an involuntary one, had the possibility of an involuntary conversion *during* liquidation come to its attention" (emphasis supplied). 149 Ct. Cl., at 129, 180 F. Supp., at 736. In *Kent*, the Fourth Circuit disallowed § 337 (a) treatment where both the fire and the settlement took place *prior* to the adoption of a plan of liquidation. 288 F. 2d, at 816. (It upheld that taxpayer's argument, however, that the casualty gain there sustained was entitled to nonrecognition specially provided under § 392 (b) of the 1954 Code.) Neither case presented the factual sequence of the case before us.

sion does not occur until settlement is reached and the insurance obligations are finally determined and paid. This essentially is the reasoning employed in the *Morton* case.

There is nothing to indicate that Congress considered this problem when § 337 (a) was adopted. The fact that attention was invariably focused on an actual sale would indicate that the casualty situation was not legislatively anticipated. *Towanda Textiles, Inc.* v. *United States*, 149 Ct. Cl. 123, 129, 180 F. Supp. 373, 376 (1960). Recourse to legislative history, therefore, is somewhat circumstantial in nature. There is, however, one guiding fact, namely, the above-mentioned clear purpose of Congress, in its enactment of § 337 (a), to avoid the *Court Holding-Cumberland* formalities.

The taxpayer's analogy to the ordinary sale transaction has some superficial appeal. It fails, however, to give sufficient consideration to the underlying purpose of § 337 (a). To be sure, under normal circumstances, a true sale is not complete until the mutual obligations (if not the precise terms) are fixed. The Internal Revenue Service has recognized this explicitly in the Regulations by making § 337 (a) available where a sale is negotiated by the corporation prior to the adoption of the plan but is not finalized until after the plan is adopted. Treas. Regs. § 1.337–2 (a).[7] This merely acknowledges

[7] The Regulations make the date of the sale dependent "primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances." § 1.337–2 (a). They provide that an "executory contract to sell is to be distinguished from a contract of sale." This distinction recognizes the significance of the point in time where the parties can no longer opt out of a transaction. Certainly, a fire insurer has no right to opt out of its coverage and basic liability after the fire takes place; in this respect, the executory contract situation referred to in the Regulations is distinguishable.

that the parties are free to avoid an executory sales contract until it is made final. If the transaction is not finalized until after the plan of liquidation is adopted, the corporation is rightfully entitled to § 337 (a) treatment. This result is fully consistent with the aim of Congress to avoid the factual determination that led to the *Court Holding-Cumberland* dichotomy. The fact that the corporation and its shareholders are given this limited opportunity to plan, preliminary and prior to liquidation, for disposal of assets does not mean that the Congress intended to make this opportunity available in every conceivable fact situation.

With a fire loss, the obligation to pay arises upon the fire.[8] Unlike an executory contract to sell, the casualty cannot be rescinded. Details, including even the basic question of liability, may be contested, but the fundamental contractual obligation that precipitates the transformation from tangible property into a chose in action consisting of a claim for insurance proceeds is fixed by the fire. Although the parties remain free to arrive at an acceptable settlement, the obligation itself has come into being, and it is the value of the insured property at that point that governs the claim. In other words, the terms of the obligation cannot be changed unilaterally by the insurer once the fire has occurred.

The fact that the ultimate extent of the gain may not be known or final settlement reached until some

[8] For tax purposes, the formality of filing a proof of claim usually does not change the substance of this conclusion. In any event, the formalities were observed here. The insurer's adjustor was in attendance even while the fire was in progress. App. 42. Notice was immediately given the insurance companies and proofs of loss were promptly submitted. *Id.*, at 13–14. Negotiations began within a month. The adjustors, in making the not uncommon rejection of initial proofs of claim, denied the extent, but hardly the fact, of coverage. *Id.*, at 14–15.

later time does not prevent the occurrence of a "sale or exchange" even in the context of a normal commercial transaction. See, *e. g., Burnet* v. *Logan,* 283 U. S. 404 (1931). The taxpayer's efforts to draw an analogy to a true sale is therefore of limited utility. See Note, Involuntary Conversions and § 337 of the Internal Revenue Code, 31 Wash. & Lee L. Rev. 417, 427–428 (1974).

When the casualty occurs during the 12-month period after the plan of liquidation is adopted, § 337 (a)'s applicability follows as a matter of course. The presence of § 337 (a) creates an expectation in the liquidating corporation that it will not be taxed on gains from sales or exchanges of corporate assets during the 12-month period. The taxpayer corporation then need not be concerned with the formalities of sale and disposal in order to avoid tax on capital gains. Put another way, once the plan is adopted, corporate property is colored with the reasonable expectation that if it is sold or exchanged within 12 months, any resulting gain will not be taxed to the corporation. It follows that if, after the plan is adopted, property is destroyed by casualty, with consequent replacement by insurance proceeds, § 337 (a) treatment is available. The property colored by the expectation has been replaced by insurance proceeds.

When, however, the casualty occurs prior to the adoption of the plan and the corporation's commitment to liquidate, none of these considerations attaches. Moreover, there is nothing in the purpose of § 337 which dictates the extension of its benefits to this preplan situation. Before the adoption of the plan the corporation has no expectation of avoiding tax if it disposes of property at a gain. The corporation, of course, is the beneficiary of the insurance, and both at the time the policy is executed and at the time of the fire, the destroyed property is an asset of the corporation. Prior to the

adoption of the plan, § 337 (a)'s "expectation" simply is not present. For all practical purposes, the disposal of Central Tablet's insured property occurred at the time of its fire. At that time the taxpayer possessed all incidents of ownership. It had evidenced no intention to liquidate. The fire was irremediable. Regardless of the formalities and negotiations that prefaced the actual insurance settlements, the property was parted with at the time of its destruction. When the casualty occurs prior to the corporation's committing itself to liquidation, no *Court Holding-Cumberland* problem is presented.

IV

This interpretation is fully consistent with the manner in which condemnation, the other principal form of involuntary conversion, is treated under § 337. In condemnation, the legally operative event for purposes of the statute is the passage of title under federal or state law, as the case may be, to the condemning authority. This means that in many jurisdictions the "sale or exchange" under § 337 (a) occurs prior to the determination of the amount of condemnation compensation and, indeed, possibly without advance warning to the corporation owner. Rev. Rul. 59–108, 1959–1 C. B. 72. It has been uniformly recognized that a corporate taxpayer may not avail itself of § 337 (a) where its plan of liquidation is adopted after title has passed by way of condemnation even where no settlement as to condemnation price has been reached or where the corporation had no advance notice of the proposed taking. *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629, 633–635 (CA8 1966); *Likins-Foster Honolulu Corp.* v. *Commissioner*, 417 F. 2d 285 (CA10 1969), cert. denied, 397 U. S. 987 (1970); *Dwight* v. *United States*, 328 F. 2d 973 (CA2 1964); *Wendell* v. *Commissioner*, 326 F. 2d 600 (CA2 1964). The taxpayer's position here would favor the casualty taxpayer over the condemnation taxpayer.

Although perhaps not an exact parallel, the one date in the casualty loss situation analogous to the passage of title in the condemnation context is the date of the casualty. The fire is the event which fixes the legal obligation to pay the insurance proceeds. As with a nonqualifying preplan condemnation, the fire is the single irrevocable event of significance, and it occurs when title and control over the property is in the corporation. The chose in action against the insurer arises at that time. This is unlike the executory sales contract consummated after the adoption of a plan; there, either of the parties is free unilaterally to avoid whatever preliminary agreement had been reached at the preliquidation negotiations. As with condemnation, the involuntary character of the fire distinguishes it from the normal sale, and, as with condemnation, for purposes of § 337 (a), it is irrelevant that the precise dollar amount of the insurer's obligation remains uncertain. In the casualty situation, the owner of the insured property is deprived of aspects of ownership when the fire occurs in much the same way as the owner of condemned property is deprived at the time title passes. In each case the triggering event is involuntary and irrevocable. Because of the statutorily imposed chronology, the event operates to prevent the corporation's receiving the favorable treatment of § 337 (a). As the *Court Holding* decision exemplifies, "This may appear a harsh result, but if it is to be corrected, Congress must act; the courts have no power to do so." *Dwight* v. *United States,* 328 F. 2d, at 974.

V

Again, although not precisely parallel and certainly not controlling, concluding the "sale or exchange" takes place at the time of the fire is consistent with the accepted method for determining the holding period of

destroyed property in the ascertainment of its long- or short-term capital gain or loss consequences. Where property is destroyed, the holding period terminates at the moment of destruction. *Rose* v. *United States*, 229 F. Supp. 298 (SD Cal. 1964); *Steele* v. *United States*, 52–2 T. C. ¶ 9451 (SD Fla. 1952); see *Fred Draper*, 32 T. C. 545, 548–549 (1959). Cf. Note, Extending Section 337 to Liquidations Triggered by the Involuntary Conversion of Corporate Assets, 62 Geo. L. J. 1203, 1213 n. 55 (1974). Were we to accept the taxpayer's argument, we would be left with the anomalous situation of having the "sale" take place after the holding period has terminated for capital gain or loss purposes.

VI

The situation presented by the instant case has been brought to the attention of Congress with the suggestion that the nonrecognition treatment provided by § 337 (a) be extended to preplan involuntary conversions.[9] Con-

[9] In 1959 the Advisory Group made the following recommendation to the House Committee on Ways and Means:

"The advisory group considers it appropriate and desirable to extend the nonrecogntion treatment provided by section 337 (a) to all involuntary conversions. Since an involuntary conversion cannot be foreseen and it is impractical to require adoption of the liquidation plan on or before the day of the conversion, it is proposed, as to such conversions, to relax the strict requirements of the section with respect to the time of adoption of the liquidation plan. Since the time of receipt of the proceeds of an involuntary conversion may depend on factors beyond the control of the corporation and receipt within a 12-month period is often impossible, it is proposed also to relax the distribution requirements with respect to such conversions. Accordingly, it is recommended that an involuntary conversion within the meaning of section 1033 be considered a sale or exchange for purposes of section 337, and that the requirements of paragraph (1)(B) regarding the time of distribution, and the requirement of paragraph (1) that the sale or exchange occur within the 12-month period referred to therein, be considered satisfied if such 12-month period begins not later than 60 days after the disposition of the

gress, however, has not acted on this suggestion. It, of course, has provided some tax relief to the victim of a casualty gain by permitting nonrecognition of the gain if the victim-taxpayer uses the proceeds to replace the destroyed property in a specified manner. § 1033 (a)(3) of the 1954 Code, 26 U. S. C. A. § 1033 (a)(3). But Congress has never disclosed an intention to permit the corporate victim of a casualty with ensuing gain to have the option of liquidating after the casualty occurs and obtaining the benefit of nonrecognition under § 337 (a). If this is desirable policy, it is for the Congress, not the courts, to effectuate. The fact that a tax-oriented and tax-knowledgeable corporation in theory could utilize § 1033 (a)(3) and rebuild with its insurance proceeds without being taxed for the gain, and then adopt a plan of liquidation, surely does not change the result. Tax consequences follow what has taken place, not what might have taken place. *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.* — U. S. —, — (1974).

Had Congress enacted § 337 for the avowed purpose of freeing a corporation from tax on gains whenever it

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converted property, as defined in section 1033 (a)(2), and the proceeds of the conversion are distributed within such 12-month period or within 60 days after the receipt thereof by the corporation, whichever is later." Hearings before the House Committee on Ways and Means on Advisory Group Recommendations on Subchapters C, J, and K of the Internal Revenue Code, 86th Cong., 1st Sess., 532 (1959). It is true that this recommendation was made before the Internal Revenue Service had recognized a casualty as a "sale or exchange," within the language of § 377 (a), and that the Service has adopted at least part of the recommendation without congressional action. Nonetheless, the Advisory Group clearly recognized that even if the involuntary conversion were a "sale or exchange," § 337 (a) did not reach the conversion that occurred prior to the adoption of the plan of liquidation, and it proposed "to relax the strict requirements of the section" with respect thereto.

decides to liquidate, the result here might well be different. Section 337, however, was not designed to accomplish that broad result. As has been noted, § 337 was designed for the limited purpose of avoiding the technical and formalistic determination of control as between the corporation and the shareholders. By the enactment of § 337 (a), the benefit of any existing doubt in that context was given to the corporate taxpayer. But § 337 (a) is narrowly and specifically drawn. It applies only to a complete liquidation and then only to one fully accomplished in a specified short time. It has no application to a sale or exchange before the adoption of the plan or to one more than 12 months after the adoption. If the statute's precise conditions are not fulfilled, the tax consequences that normally prevail will ensue. Indeed, the statute is not always beneficial, for it operates to make a loss as well as a gain on the sale or exchange nonrecognizable.

The judgment of the Court of Appeals is affirmed.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 73–593

Central Tablet Manufacturing Co., Petitioner, *v.* United States.	On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

[June 19, 1974]

MR. JUSTICE WHITE, with whom MR. JUSTICE DOUGLAS, MR. JUSTICE BRENNAN, and MR. JUSTICE POWELL join, dissenting.

Ordinarily, gain from the sale of corporate property is taxed to the corporation. Under 26 U. S. C. § 337, however, gain from a sale or exchange occurring within 12 months after the adoption of a plan of liquidation is not recognized or taxed to the corporation. Concededly, the section applies to gain from involuntary conversions such as fire losses compensated by insurance, as long as the event qualifying as the sale or exchange takes place after, rather than before, the adoption of a plan of liquidation. As the Court indicates, the sole issue in this case is when the sale or exchange occurred.

Here, the fire took place on September 10, 1965. The plan of liquidation was not adopted until May 14, 1966. But the destroyed property was insured, and the insurance claims were finally negotiated, settled and paid after May 14, 1966. The Court holds that the sale or exchange took place at the time of the fire; for in its view, it was the fire that transformed "tangible property into a chose in action consisting of a claim for fire insurance proceeds . . . ." *Ante*, p. 12.

I disagree. That the fire gave the company a claim under its insurance policies does not mean that the involuntary conversion qualifying as a sale or exchange

took place at that moment. It is my view that such a claim does not ripen into a sale or exchange until it has attained a sufficiently definite quality and value to require the gain or loss to be accrued on the books of an accrual basis taxpayer. It is plain enough for me that no gain was accruable by Central Tablet until after May 14, 1967, and that the sale or exchange therefore took place after rather than before the adoption of the liquidation plan.

The general rule is that "there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." 26 U. S. C. § 165. Without doubt, had there not been insurance in this case, Central Tablet would have suffered a deductible loss from the fire and that deduction would have been taken in the year the fire occurred. The ordinary rule also is, however, that deductible losses must be evidenced by closed and completed transactions and fixed by identifiable events. *Boehm* v. *Commissioner*, 326 U. S. 287, 291 (1945). In the context of an insured fire loss, where recovery of insurance is uncertain or unrealistic the loss is to be taken in the year it occurs. *Coastal Terminals, Inc.* v. *Commissioner*, 25 T. C. 1053 (1956); *Cahn* v. *Commissioner*, 92 F. 2d 674 (CA9 1937). But if there is a fair prospect of recovering insurance proceeds, the loss is to be postponed until the question of recovery is sufficiently settled. *Commissioner* v. *Harwick*, 184 F. 2d 835 (CA5 1950); *Boston & M. R. R.* v. *C. I. R.*, 206 F. 2d 617 (CA1 1953); *Charles F. Jeffrey*, 12 T. C. M. 534 (1953).[1]

[1] Treas. Reg. § 1.165–1 (d)(1) and (2) provide:

"(d) *Year of deduction.* (1) A loss shall be allowed as a deduction under section 165 (a) only for the taxable year in which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year. For provisions relating to

Similar principles apply to determine when an accrual basis taxpayer realizes income when an insured fire loss results in taxable gain. Under general principles of

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situations where a loss attributable to a disaster will be treated as sustained in the taxable year immediately preceding the taxable year in which the disaster actually occurred, see section 165 (h) and § 1.165–11.

"(2)(i) If a casualty or other event occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or by an abandonment of the claim. When a taxpayer claims that the taxable year in which a loss is sustained is fixed by his abandonment of the claim for reimbursement, he must be able to produce objective evidence of his having abandoned the claim, such as the execution of a release.

"(ii) If in the year of the casualty or other event a portion of the loss is not covered by a claim for reimbursement with respect to which there is a reasonable prospect of recovery, then such portion of the loss is sustained during the taxable year in which the casualty or other event occurs. For example, if property having an adjusted basis of $10,000 is completely destroyed by fire in 1961, and if the taxpayer's only claim for reimbursement consists of an insurance claim for $8,000 which is settled in 1962, the taxpayer sustains a loss of $2,000 in 1961. However, if the taxpayer's automobile is completely destroyed in 1961 as a result of the negligence of another person and there exists a reasonable prospect of recovery on a claim for the full value of the automobile against such person, the taxpayer does not sustain any loss until the taxable year in which the claim is adjudicated or otherwise settled. If the automobile had an adjusted basis of $5,000 and the taxpayer secures a judgment of $4,000 in 1962, $1,000 is deductible for the taxable year 1962. If in 1963 it

accrual accounting, two conditions must be met for income to be accrued in a given taxable year: the taxpayer must have a clear right to the income, and the quantum of the income must be ascertainable within reasonable limits. *United States* v. *Anderson*, 269 U. S. 422, 441 (1926); *Continental Tie & L. Co.*, 286 U. S. 290, 297 (1932); *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516, 519 (1944). "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability. . . ." *Dixie Pine Co., supra.* These twin conditions have been formalized by Treas. Reg. 1.451–1 (a), which provides in relevant part:

> "Under an accrual method of accounting, income is includable in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. . . ."

These are the governing principles when the issue is whether income from certain insurance policies covering business or personal loss had accrued to the taxpayer. Thus, where an insurance company does not admit liability in the year of the loss, or takes a position in negotiations which makes it quite uncertain whether the bulk of the claim will be recoverable, accrual is improper.[2]

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becomes reasonably certain that only $3,500 can never be collected on such judgment, $500 is deductible for the taxable year 1963.

"(iii) If the taxpayer deducted a loss in accordance with the provisions of this paragraph and in a subsequent taxable year receives reimbursement for such loss, he does not recompute the tax for the taxable year in which the deduction was taken but includes the amount of such reimbursement in his gross income for the taxable year in which received, subject to the provisions of section 111, relating to recovery of amounts previously deducted."

[2] *Maryland Shipbuilding & Drydock Co.* v. *United States*, 409 F. 2d 1363 (Ct. of Claims 1969) (accrual not required because extent

Although it may generally be true that taxpayers seek to delay reporting income, this may not be so when there are large losses in the year of the conversion to absorb the insurance income. In that situation, the Commissioner may advocate that accrual in the year of the loss is improper. See *E. T. Slider, Inc.*, 5 T. C. 263 (1945) (accrual improper in year of loss because collectability of insurance proceeds doubtful). The principles of accrual accouting are designed to be neutral, so that the taxpayer may not time his gains and losses in inconsistent fashion to minimize his tax liability.

If normal accrual accounting principles were to be applied in this case, it is clear that whatever the date on which income accrued to the corporation, it would not be the date of the fire, as the Court of Appeals held. At least some period of time, however short, must be allowed

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of liability contested by insurance company in negotiations not completed in taxable year); *Cappel House Furnishing Co.* v. *United States*, 244 F. 2d 525 (CA6 1957) (Liability and approximate amount determined in year of fire because of unreasonable delay of taxpayer in presenting claim, and liability was both clear and could be approximated); *Georgia Carolina Chemical Co.* v. *Commissioner*, 3 T. C. M. 1213 (1944) (extent of liability not fixed in year of loss because of uncertainty as to whether co-insurance clause, which would reduce coverage, would be invoked by insurance company); *Luckenbach Steamship Co.*, 9 T. C. 662 (1947) (amount of recovery on war risk insurance uncertain in years of loss because of controversy between War Shipping Administration and Comptroller General); *Rite Way Products, Inc.*, 12 T. C. 475 (1949) (extent and amount of liability of insurance company known in year of loss); *Thalimer Brothers*, 27 T. C. 733 (1957) (where fire occurred six days prior to completion of tax year, insurance proceeds did not accrue because extent of damage still uncertain); *Curtis Electro Lighting*, 60 T. C. 633 (1973) (accrual not required because insurance company had never admitted to liability in any amount in taxable year); *Max Kurtz*, 8 B. T. A. 679 (1927) (accrual required where insurance company had admitted liability and conceded the bulk of the loss claimed by the taxpayer in the year of the loss).

for the taxpayer to determine the extent of loss and to file a timely proof of loss form with the insurer. Cf. *Thalimer Brothers, supra.* The question then becomes whether the amount should have accrued prior to or during the 12-month period beginning on May 14, 1966, the date on which the liquidation plan was adopted. This is largely a factual question, depending on whether liability was acknowledged, and whether the amount of liability was reasonably ascertainable before or after the adoption of the plan.

As to the issue of liability, there was some disagreement between the District Court and the Court of Appeals. The District Court found that "[a]t no time was an express admission of liability made by taxpaper's insurance adjusters. Indeed, there is some evidence in the record that the insurance companies denied that notice of claim was properly given." 339 F. Supp., at 1139. The District Court further found that even if liability had been admitted at some point, there was insufficient evidence in the record to determine at what point that admission occurred, even though that subject had been explored at trial. The Court of Appeals, on the other hand, believed that "the insurance carrier questioned neither the validity of the insurance contracts nor the fufillment of the conditions for payment thereunder. . . ." 481 F. 2d, at 956.

However, even accepting the view of the Court of Appeals that liability was not at issue, both courts found that the amount of liability was subject to dispute and negotiations. A number of issues divided the parties throughout the negotiations on the extent of coverage. Negotiations of Central Tablet's claim for business interruption loss began on approxmately October 8, 1965. Disputes subsequently arose over the estimated period of loss to be covered and the probable duration of the strike had there not been a fire, for the purpose of deter-

mining the "actual loss sustained." No settlement on this claim was negotiated until August 25, 1967, and, on or about September 22, 1967, petitioner received payment of $67,000, as compared with the maximum of $200,000 available under the two policies, which represented petitioner's initial request in the negotiations.

Negotiation of the building, machinery and personal property loss claims began on approximately November 1, 1965. On the building insurance policy, dispute focused on a co-insurance clause.[3] The District Court found that the questions over the applicability of the clause would reduce petitioner's coverage by 43%, if the companies prevailed. The parties also disagreed as to the extent of building loss and the value of the building at the time of the loss. Central Tablet accepted a settlement of its claim on approximately May 20, 1966, and, on June 15, 1966, received $174,595.05 in payment, as compared with the $225,000 stated maximum.

Finally, as to the personal property policy, dispute focused on the value of machinery and equipment and the cost of repair of repairable machinery and equipment. On approximately August 25, 1966, Central Tablet accepted a $104,609.27 settlement on this claim, as compared with the $450,000 stated maximum.

The District Court stated that these negotiations were "exceedingly complex and difficult," and "[i]n each case, substantial discrepancies existed between the initial offers made by the insurance companies, the maximum permis-

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[3] This is formally termed a replacement cost endorsement co-insurance clause. The insurance adjustor explained at trial that a replacement cost endorsement is bought by the insured to cover, in the event of compensable loss, the replacement cost of lost property. The co-insurance clause requires that the insured carry coverage up to a sufficient limit so that the premiums will justify the coverage. He additionally explained that, if the premiums are determined not to justify the actual replacement cost, coverage is reduced.

sible coverage, and the amounts ultimately negotiated." 339 F. Supp., at 1139. Due to the factual record before it, the District Court concluded that the insurance proceeds did not accrue until after the plan had been adopted. The court stated that "it would be an utter fiction for us to conclude that the taxpayer realized fixed and estimable income before it adopted the plan of liquidation. . . ." *Ibid.* The Court of Appeals also recognized that there was a dispute over the amount to be paid under each policy. The factual findings of the District Court were consistent with the well-settled rule that accrual is only required when the quantum of income is ascertainable within reasonable limits. On the two insurance policies at issue here, the amounts received, $174,000 on the building policy and $104,000 on the personal property policy, compared with stated maximums of $225,000 and $450,000, respectively. These discrepancies bolster the District Court's conclusion that there were substantial disagreements between the parties.

The general rule is that "[t]axable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books." 26 U. S. C. § 446. Central Tablet was an accrual basis taxpayer, and it is clear that the amount of the insurance proceeds was not ascertainable with reasonable certainty until after May 14, 1967. No gain was accruable prior to that date, and the District Court was clearly right in holding that there had been no involuntary conversion and no sale or exchange prior to the adoption of the plan of liquidation. Absent the insurance policy, there could have been only a casualty loss, no "involuntary conversion" and no "sale or exchange." And with the various insurance policies owned by the taxpayer, the conversion into cash in an amount reasonably ascertainable did not become sufficiently predictable until after May 14, 1966.

To me, the Government's position in this case is anomalous. Although in arguing that the "sale or exchange" must be deemed to have occurred on the date of the fire, it was suggested by the Government in the Court of Appeals that if the issue were decided in favor of the Government, then a remand would be in order to determine in which year the gain was taxable. The Court of Appeals, whose judgment is now affirmed, followed this suggestion and remanded the case to the District Court. It is thus possible that the District Court, having already once concluded that the gain was not realized until the period of liquidation had begun in 1966, will reach the same conclusion on remand; but the gain under the Court's holding will nonetheless be taxable to the corporation. This seems a very odd result, for if insufficient events occurred in 1965 to warrant the accrual of gain by an accrual basis taxpayer, it is incongruous to hold that an involuntary converison based on the collectibility of insurance proceeds nevertheless occurred at the time of the fire. In the context of the compensated fire loss, the time of realizing gain is the more realistic criterion of when the sale or exchange takes place within the meaning of § 337.

The statute does not tell us when an involuntary conversion qualifying as a sale or exchange must be deemed to have taken place. It provides sufficient flexibility so that in ordinary liquidations, sales or exchanges may be negotiated and all but finalized by the corporation before the plan is adopted. It is contemplated that the corporate taxpayer may plan the liquidation and the timing of gains and losses from liquidating sales and exchanges. I perceive no reason why Congress would treat those whom accident forces to convert their property into cash any less favorably than those who have total control of whether a sale is to be made at all. If a compensated

fire loss qualifies as a sale or exchange, as the Government concedes it does, it appears perfectly consistent with the terms as well as the purpose of § 377 to hold that the qualifying event occurs when the gain is realized and must be accrued. This would place those who are forced to liquidate on a par with those who chose to liquidate and to realize gains without paying the corporate tax.

The Commissioner argues, however, that there is an analogy between the treatment of condemnation "conversions" and losses by accidents. He would apply to compensated fire losses the uniform rule of the courts of appeal that a corporation is not entitled to the benefits of § 337 when property is condemned prior to the adoption of a liquidation plan. *Wendell* v. *Commissioner*, 326 F. 2d 600 (CA2 1964); *Dwight* v. *United States*, 328 F. 2d 973 (CA2 1964); *Covered Wagon Inc.* v. *Commissioner*, 369 F. 2d 629 (CA8 1966); *Likins-Foster Honolulu Corp.* v. *Commissioner*, 417 F. 2d 285 (CA10 1969). The rule in condemnation cases, however, is not directly at odds with accrual accounting principles. Recognition of income is required at the time of a taking which transfers title to the property and creates an immediate obligation upon the condemning authority to pay just compensation. Rev. Rul. 59–108, 1959–1 C. B. 72. At the time the Government takes title to the property, it offers to pay a certain amount, thereby fixing its liability in a reasonably ascertainable amount. Under federal law, when the United States condemns property, it files its Declaration of Taking and deposits the amount of estimated compensation for the property into court. *Covered Wagon, Inc., supra*, 369 F. 2d, at 634. The taking vests title in the Government, the condemnee is deprived of his property and he is certain to recover at least the fair market value estimated by the Government.[4]

[4] The Commissioner also seeks to analogize this case to those dealing with computing of the holding period of lost or destroyed prop-

This is not the case here. The fire is an irrevocable event and except for the insurance, it would represent a loss immediately accruable. But with insurance coverage, there may be a gain, the amount of which may or may not be reasonably ascertainable, either then or within a short time; and until it is ascertainable, normal rules of accrual accounting would not require any gain to be recognized and until that occurs the transaction has not sufficiently congealed to qualify as a sale or exchange.

I add a final note. The controlling Treasury regula-

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erty in connection with measuring whether the gain from the sale of a capital asset is taxable as short-term or long-term capital gain or ordinary income. See *Rose* v. *United States*, 229 F. Supp. 298, 300 (SD Cal. 1964); *Steele* v. *United States*, 52-2 U. S. T. C. ¶ 9451 (SD Fla. 1952). In *Rose*, which dealt with involuntary conversion in 1960, the holding period of the asset was found to terminate when the ship involved was lost at sea, rather than when insurance proceeds were received. The test for the dating of the end of the holding period is when the benefits or burdens of ownership are transferred or when title passes, whichever occurs first. See Comment, Extending Section 337 to Liquidation Triggered By the Involuntary Conversion of Corporate Assets, 62 Geo. L. J. 1203, 1213 n. 55 (1974). In *Rose*, when the ship was lost the owners totally abandoned it and gave all rights to salvage income to the insurer. Thus, all rights of ownership were relinquished at the time of the loss. The case does not relate to the timing of the receipt of income, as does the instant case, but only to the period of time a capital asset is held. The parties in *Rose* did not dispute that the gain, whether it be short- or long-term, as determined by the holding period, was to be recognized in 1960. This was largely because it appears that all relevant events occurred in that year; the loss, admission of liability, and settlement.

In *Steele*, there was also no dispute as to the timing of recognition. The taxpayer, reporting on a cash basis, received insurance in 1944 for the loss which occurred in 1943. The Commissioner asserted a deficiency for *1944*. Even though the court held that there was not a 6-month holding period, so that the gain was ordinary income, it was still incurred in 1944, the date of the receipt of insurance proceeds, and not in 1943, the date of the loss of the vessel.

tions under § 337 provide considerable flexibility to the parties in liquidation situations. Indeed, Treas. Reg. § 1.337–1 provides that "sales may be made *before* the adoption of the plan of liquidation if made on the same day such plan is adopted." (Emphasis added.) Thus, even under the Court's view that the sale or exchange occurs at the time of the fire, § 337 would be available to the property owner if he were sufficiently aware and took sufficient pains to plan in advance to comply with the regulation or was a closely held corporation that could adopt its liquidation plan before the day of the fire was over. Other taxpayers not so inclined or so circumstanced to provide for contingencies would be foreclosed. Section 337 would remain a trap for the unwary, the precise situation Congress sought to avoid.